# FEDERAL TAX RULES RELATING TO DISCLAIMER OF PROPERTY INTERESTS CREATED BY TRANSFERS

## HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

SECOND SESSION

MAY 7, 1984

**Serial 98–71**

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE
35-452 O · WASHINGTON : 1984

H781-53

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# FEDERAL TAX RULES RELATING TO DISCLAIMER OF PROPERTY INTERESTS CREATED BY TRANSFERS

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MONDAY, MAY 7, 1984

House of Representatives,
Committee on Ways and Means,
Subcommittee on Oversight,
*Washington, DC.*

The subcommittee met at 1 p.m., pursuant to notice, in room B-318, Rayburn House Office Building, Hon. Charles B. Rangel (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

[Press release of Monday, April 30, 1984]

HON. CHARLES B. RANGEL (D., N.Y.), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES HEARING ON THE FEDERAL TAX RULES RELATING TO THE DISCLAIMER OF PROPERTY INTERESTS CREATED BY TRANSFERS

The Honorable Charles B. Rangel (D., N.Y.), Chairman of the Subcommittee on Oversight of the Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee on Oversight will hold a hearing to review the Federal tax rules regarding disclaimers of certain property interests created by transfer. The hearing will examine the Supreme Court's decision in *Jewett* v. *Commissioner* that for interests in property created prior to December 31, 1976, a qualified disclaimer will result only if the interest is disclaimed within a reasonable time from the transfer creating the interest. Testimony will be received from the Administration, invited and public witnesses. The Subcommittee hearing is being held at the request of the Chairman of the Committee on Ways and Means, the Honorable Dan Rostenkowski. The hearing will be held on Monday, May 7, 1984, beginning at 1:00 p.m., in Room B-318 Rayburn House Office Building.

In general, a disclaimer is a refusal to accept the ownership of property or rights with respect to property. If a qualified disclaimer is made, the Federal gift, estate and generation-skipping transfer tax provisions apply as if the interest had never been transferred to the person making the disclaimer. As a result, the transfer of the property pursuant to the disclaimer will not be treated as a taxable gift.

In the Tax Reform Act of 1976, the Congress adopted a set of uniform rules to govern disclaimers of property interests transferred after December 31, 1976 (I.R.C. Section 2518). Prior to the 1976 Act, there were no uniform Federal statutory disclaimer rules. Before the promulgation of Treasury regulations in 1958, the administrative practice of the Internal Revenue Service was to allow the Federal tax consequences of a disclaimer to depend upon its treatment under local law. In 1958, the Treasury Department issued regulations which provided that transfers of property pursuant to a disclaimer would not be treated as a taxable gift if the disclaimer (1) were effective under local law, and (2) were made within a reasonable time after knowledge of the existence of the transfer. The regulations applied to interests created by a transfer both before and after 1958. As a result, a disclaimer of an interest created in a transfer prior to November 15, 1958, would be qualified for Federal tax purposes only if it were made within a reasonable time after the original transfer creating the interest. Disputes as to the timing of a qualified disclaimer have generated considerable litigation. The U.S. Supreme Court upheld the Treasury regulations in *Jewett* v. *Commissioner,* 102 S.Ct. 1082 (1982).

### DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD

Individuals and organizations interested in presenting oral testimony before the Subcommittee must submit their requests to be heard by telephone to Harriett Lawler [(202) 225-3627] no later than noon, Friday, May 4, 1984, to be followed by a formal written request to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. Notification to those scheduled to appear will be made by telephone as soon as possible after the filing deadline.

It is urged that persons and organizations having a common position make every effort to designate one spokesman to represent them in order for the Subcommittee to hear as many points of view as possible. Time for oral presentations will be strictly limited with the understanding that a more detailed statement may be included in the printed record of the hearing. This process will afford more time for members to question witnesses. In addition, witnesses may be grouped as panelists with strict time limitations for each panelist.

In order to assure the most productive use of the limited amount of time available to question hearing witnesses, witnesses scheduled to appear before the Subcommittee are required to submit 100 copies of their prepared statements to the full Committee office, room 1102 Longworth House Office Building, at least 24 hours in advance of their scheduled appearance. Failure to comply with this requirement may result in the witness being denied the opportunity to testify in person.

Requests to be heard must contain the following information:

1. The name, full address, and capacity in which the witness will appear, as well as a telephone number where he or his designated representative may be reached;
2. A list of any clients or persons, or any organization for whom the witness appears; and
3. A topical outline or summary of comments and recommendations.

The above information should also be incorporated in the prepared statements to be presented in person as well as those filed for the printed record of the hearing.

### WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE

Persons submitting a written statement in lieu of a personal appearance should submit at least six (6) copies of their statement by close of business, Friday, May 11, 1984, to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Washington, D.C. 20515. If those filing written statements for the record of the printed hearing wish to have their statements distributed to the press and the interested public, they may provide 75 additional copies for this purpose to the full Committee office before the hearing begins.

Chairman RANGEL. The subcommittee will come to order.

My colleague and adviser on matters this complex I hope would join me, since his name is here, unless you feel more comfortable down there.

Mr. CONABLE. No, no. Your dependency ill-befits you.

Chairman RANGEL. On matters like this, I am certain you can be of great help.

Today's hearing will focus on the Federal tax rules that are applicable to disclaimers of certain property interests that are created by transfers before November 15, 1958. This is the date regulations providing rules for making qualified disclaimers for Federal tax purposes were promulgated by the Treasury Department.

More specifically, the hearing will examine the Supreme Court's 1982 decision in *Jewett* v. *Commissioner,* which held that a disclaimer of property interest is effective only if the interest was disclaimed within a reasonable time from the transfer creating the interest.

Briefly, a disclaimer is a donee's refusal to accept ownership of property or rights with respect to that property. If a donee does not properly disclaim property, the property becomes the donee's. And on subsequent transfer, the donee may be subject to Federal estate, gift, or generation skipping transfer taxes.

On the other hand, if a qualified disclaimer is made, the property passes as though the person making the disclaimer had never received the property. As a result, the property passes to the succeeding beneficiary without any tax liability that could arise upon a transfer by the person making the disclaimer. As we will see, a disclaimer may be used as a very effective estate planning tool.

H.R. 2813, introduced by Mr. Conable, and identical provisions contained in the Senate tax bill, will treat as qualified certain pre-1958 disclaimers and, in effect, would overrule the Supreme Court's decision in *Jewett*. The Subcommittee on Select Revenue Measures is the usual forum for such special relief. However, the chairman of the full committee has asked me, as chairman of the Oversight Subcommittee, to hold hearings on this matter.

Before we call our first witness, I will ask Mr. Conable whether he has a statement.

## STATEMENT OF HON. BARBER B. CONABLE, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. CONABLE. Mr. Chairman, at this point I have a statement I would like to put in the record relative to my bill.

It is, I believe, understood that this bill is similar to part of the Senate bill that will be going to conference shortly, and I appreciate your holding this hearing so that the issue can be considered on the merits, and, will not be subject to an objection relative to procedure.

I am sure that the hearing will be illuminating, and I stand ready to answer any questions.

I would like to submit my statement for the record.

Chairman RANGEL. Without objection.

[The statement of Mr. Conable follows:]

### STATEMENT OF HON. BARBER B. CONABLE, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. Chairman, and my colleagues, I urge you to support H.R. 2813 to correct an inequity which has developed in the tax law since the enactment of the Tax Reform Act of 1976. As some of you may recall, in 1976 Code Section 2518 was enacted to clarify and make uniform the treatment, for federal gift tax purposes, of disclaimers of interests in property. A disclaimer is a refusal to accept a gift or bequest with the result that the property passes automatically to a successor. If a disclaimer is valid for gift tax purposes, the disclaiming person is not deemed to have made a gift, and no additional gift tax liability results.

It was my understanding, as set forth in the Ways and Means Committee Report on the Estate and Gift Tax Reform Act of 1976 (H.R. 14844), that disclaimers which were valid under local law and which were made within a "reasonable time", as that term was construed under local law, also were valid for federal gift tax purposes. (See H. Rept. No. 94-1380, 94th Congress, 2d Sess. (1976) at p. 66.) In support of this understanding, the Committee Report cited the decision of the Eighth Circuit Court of Appeals in *Keinath* v. *Commissioner*, 480 F. 2d 58 (8th Cir. 1973) which had so held. Accordingly, Code Section 2518 was enacted to prevent differences in local property law from creating differences in federal gift tax treatment and to create uniform rules for the future.

In 1982, the Supreme Court overturned the *Keinath* decision, and thereby created gift tax liability for disclaimers even of interests created on or before November 14, 1958, when the Treasury Department first published a regulation indicating that disclaimers must be made within a period of time after the original transfer rather than within a period after the disclaiming party would otherwise be entitled to enjoy the benefits of the property. I believe that if, in 1976, this Committee had forseen the scope of the Supreme Court decision, we would have acted to preserve the validity of such disclaimers. In the companion provisions dealing with generation skipping transfers, we explicitly prevented changes in the tax treatment of existing interests during an extended grace period. We did not act in this case because it appeared that disclaimers of existing interests within a reasonable time after the property passed to the taxpayer were automatically valid by application of local law.

H.R. 2813 appears to be very narrowly drawn. It permits beneficiaries of interests (created before November 15, 1958), who have never accepted any of the benefits from the interest, to execute a valid disclaimer. If this Committee does not act, taxpayers who disclaimed such interest in reliance on the *Keinath* decision and on the common understanding, which was shared by this Committee, that local law would be applied to determine the validity of those disclaimers, will be subject retroactively to a gift tax. In at least one case, this tax may force the taxpayers into bankruptcy. This Committee consistently has opposed such unforeseen changes in the impact of our tax laws. Accordingly, I urge you to favorably report H.R. 2813.

Chairman Rangel. The Treasury Department witness today is Robert Woodward, the Tax Legislative Counsel. We appreciate your attendance here.

## STATEMENT OF ROBERT G. WOODWARD, TAX LEGISLATIVE COUNSEL, DEPARTMENT OF THE TREASURY

Mr. Woodward. Thank you, Mr. Chairman.

I am pleased to have this opportunity to present the views of the Treasury Department on the gift tax treatment of disclaimers under the Supreme Court decision in *Jewett* v. *Commissioner.* The Treasury strongly opposes legislation that would grant retroactive relief from gift taxes to taxpayers who have made disclaimers which the Supreme Court has now ruled were taxable.

Treasury also opposes giving an additional group of taxpayers—who are beneficiaries of pre-November 15, 1958 trusts—the right to transfer their interests in those trusts free from gift taxes.

By way of background, a gift tax regulation adopted on November 15, 1958 provides that a refusal to accept ownership of property transferred to an individual constitutes a taxable gift by the individual to the person who takes the property as a result of the refusal, unless the refusal is made within a reasonable time after knowledge of the existence of the transfer. This regulation relates only to transfers made before 1977 in view of a provision of the Tax Reform Act of 1976.

Under the regulation, in the case of property transferred in trust, the IRS view generally is that the transfer of the property to the trust is the transfer that begins the reasonable time period prescribed by the regulation. Thus, under the regulation, a trust beneficiary may make a tax-free disclaimer of his interest in the trust only if the disclaimer is made within a reasonable period of time after the beneficiary learns of the creation of his interest in the trust.

In the *Jewett* case, the taxpayer was a contingent remainder beneficiary of a substantial trust created under the will of his grandmother, Margaret Weyerhaeuser Jewett, who died in 1939. The taxpayer was to receive one-half of the trust property upon the death of the survivor of his parents; if the taxpayer failed to survive his parents, his share of the trust would pass to his issue.

In 1972, while the trust had a value of $8 million and the taxpayer's interest was still contingent on his surviving his mother, the taxpayer disclaimed his interest in favor of his children, who were the great-grandchildren of the individual who created the trust. The trust in the *Jewett* case had been used to skip the generation of the taxpayer's parents for transfer tax purposes. The taxpayer sought through the disclaimer mechanism to skip his own generation so as to avoid a second level of transfer taxes in the passage of the property down through his family.

The taxpayer in *Jewett* argued that the reasonable time period referred to in the regulation should begin only after the beneficiary's interest in the trust becomes vested. The Supreme Court, however, rejected the taxpayer's argument, concluding that the IRS position as to the commencement of the reasonable time period was supported by both the text and the administrative history of the regulation.

The Court also rejected summarily the taxpayer's argument that it was unfair to apply the 1958 regulation retroactively to an interest that had been created before the regulation was issued, finding that the taxpayer had no right that was taken away by the regulation. In rejecting the taxpayer's equitable arguments, the Court observed pointedly that the taxpayer had made no argument that the taxation of disclaimers under the 1958 regulation is inconsistent with the statutory provisions imposing a gift tax, which were enacted before the creation of the trust in question. The Court also noted that the disclaimers in question were executed well after promulgation of the 1958 regulation.

The Supreme Court's decision in *Jewett* had the effect of resolving a number of pending gift and estate tax cases in favor of the Government. The taxpayers in these cases, and presumably others who wish to transfer their interests in pre-November 15, 1958, trusts without incurring gift taxes, are now seeking legislative relief from the Supreme Court's decision.

Section 803 of the Senate amendment to H.R. 2163 would provide that the disclaimer of any interest created by a transfer prior to November 15, 1958, will be timely for estate and gift tax purposes if the disclaimer is made not later than 90 days after the bill's enactment. Similar legislation is contained in H.R. 2813, which has been introduced in the House.

These bills would relieve the existing gift tax liabilities of taxpayers in the *Jewett* case and other pending cases controlled by that decision. The proposed legislation also would provide a 90-day open season to allow other beneficiaries of trusts created before November 15, 1958, to make tax-free transfers of property by disclaiming their interests in those trusts.

The primary argument—as we understand it—being advanced in support of the proposed legislation is that the 1958 Treasury regulation unfairly deprived beneficiaries of preexisting trusts of their right to make disclaimers of their contingent interests. The arguments in support of the legislation are essentially the same as the equitable arguments made by the taxpayer in the *Jewett* case.

The Treasury Department strongly opposes H.R. 2813 and section 803 of the Senate amendment. The 1958 regulation is clearly a correct application of the gift tax statute to the disclaimers in question. The arguments advanced by the proponents of the legislation concerning the retroactive effect of the regulation were fully considered and rejected by the Supreme Court in *Jewett*. We believe the Supreme Court's judgment was correct and should not be overridden by the Congress.

It should be emphasized that the consequence of not enacting the relief legislation in this case would be simply to leave the affected individuals in a situation where they made transfers of substantial value to the natural objects of their bounty and have paid gift taxes on those transfers. Indeed, it is likely in most cases that the gift tax liabilities incurred are considerably less than the estate taxes which eventually would have been payable had the disclaimers not been made. As a result, the taxpayers were in a sort of "heads we win, tails we break even" situation at the very worst.

If their interpretation of the gift tax regulation had been sustained, they would have made transfers of substantial value to their children free from any transfer tax. The taxpayers could take comfort in the fact that if the courts ultimately ruled against them on the gift tax question, they still would save estate taxes by incurring lesser amounts of gift taxes in connection with the transfers.

These transfers were made before the 1976 unification of the estate and gift taxes, which means that the gift taxes were imposed at a low rate, the tax was not included in the tax base, and there was not a cumulative schedule for both gift and estate tax purposes. As a result, the disclaimer transactions that are involved in the pending cases clearly were attractive gambles.

We can see no reason why Congress ought now to give back the gift taxes these taxpayers have incurred through their aggressive tax planning. We have an example in our statement that focuses on the facts in the *Jewett* case to illustrate the point of what was involved in that case. If the taxpayer in the *Jewett* case had really thought that the reasonable time period begins only when his interest vests in the trust, he would have waited until that event occurred. Instead, he went ahead and disclaimed while his mother was still living, which calls into question his argument that he was relying on the reasonable time period interpretation of the regulation that was rejected ultimately by the Supreme Court.

What was really involved in that case is that the taxpayer, who indeed reported the disclaimer on his gift tax return, taking the position it was not taxable, certainly knew there might be a taxable gift involved and decided nevertheless to go forward, in all likelihood because he knew that by making a gift he would be able to get future appreciation on the trust property out of his estate for transfer tax purposes.

We are even more troubled by the provision in the pending legislation which would open a 90-day window for tax-free transfers by beneficiaries of trusts established before November 15, 1958. Many of these individuals have known about their interests for decades and have treated them as part of their net wealth for purposes of financial and estate planning.

To allow these individuals to disclaim interests now would give them an unexpected and unwarranted windfall. It also would force estate planners to comb their files to ferret out all the pre-November 15, 1958, interests which their clients could disclaim without tax consequences.

Mr. Chairman, before concluding I would like to turn for a moment from the specific issue of disclaimers to the general question of whether Congress should provide retroactive relief for taxpayers adversely affected by a Supreme Court decision in tax cases.

At the present time, Congress is considering relief not only in this case but also in the case of *Dickman* v. *Commissioner,* involving gift tax consequences of interest-free loans, and in the case of *Diedrich* v. *Commissioner,* involving the income tax consequences of net gifts of appreciated property. In all three of these cases, the taxpayers relied on favorable decisions of courts of appeal that subsequently were overturned by the Supreme Court. Each of these cases reached the Supreme Court only because a conflict developed between the circuits on the legal issues involved.

If Congress decides to grant relief in these cases, it seems to us that it would be sending a message that as soon as a court of appeals in one circuit decides an issue in favor of the taxpayer—even though the Government continues to litigate the issue, as it often does in order to protect the revenues and to seek the correct nationwide rule in interpreting the tax laws—taxpayers will be encouraged to take aggressive positions trying to rely on that decision, with the knowledge that even if the Supreme Court ultimately rules in favor of the Government, they will stand a very good chance of getting retroactive relief from the Congress. We think that that would have very serious implications for our tax system.

Mr. Chairman, this concludes my prepared remarks, and I would be happy to answer your questions.

[The prepared statement follows:]

## STATEMENT OF ROBERT G. WOODWARD, TAX LEGISLATIVE COUNSEL, DEPARTMENT OF THE TREASURY

Mr. Chairman and members of the subcommittee, I am pleased to have this opportunity to present the views of the Treasury Department on the gift tax treatment of disclaimers under the Supreme Court decision in *Jewett* v. *Commissioner,* 545 U.S. 305 (1982). The Treasury Department strongly opposes legislation that would grant retroactive relief from gift taxes to those taxpayers who made disclaimers governed by the *Jewett* decision. Treasury also opposes giving an additional group of taxpayers who are beneficiaries of pre-November 15, 1958 trusts the right to transfer their interests in those trusts free from gift tax.

### BACKGROUND

Section 25.2511-1(c) of the Gift Tax Regulations, which was adopted on November 15, 1958, provides that a refusal to accept ownership of property transferred to an individual constitutes a taxable gift by the individual to the person who takes the property as a result of the refusal, unless the refusal is made "within a reasonable time after knowledge of the existence of the transfer." (Because of the enactment of Internal Revenue Code section 2518 in the Tax Reform Act of 1976, this regulation relates only to interests created in taxable transfers made before 1977.) In the case of property transferred in trust, the position of the Internal Revenue Service generally is that the transfer of the property to the trust is the "transfer" that begins the "reasonable time" period prescribed by regulation. Thus, under the regulation, a trust beneficiary may make a tax-free disclaimer of his interest in the trust only if the disclaimer is made within a reasonable period of time after the beneficiary learns of the creation of his interest in the trust.

In the *Jewett* case, the taxpayer was a contingent remainder beneficiary of a substantial trust created under the will of his grandmother, Margaret Weyerhaeuser Jewett, who died in 1939. The taxpayer was to receive one-half of the trust property upon the death of the survivor of his parents; if the taxpayer failed to survive his parents, his share of the trust would pass to his issue. In 1972, while the trust had a value of $8 million and the taxpayer's interest was still contingent on his surviving his mother, the taxpayer disclaimed his interest in favor of his children (the great-grandchildren of the individual who created the trust).

The taxpayer argued that the reasonable time period referred to in the regulation should begin only after the beneficiary's interest in the trust becomes vested. The Supreme Court, however, rejected the taxpayer's argument, concluding that the IRS position as to the commencement of the reasonable time period was supported by both the text and the administrative history of the regulation. The Court also rejected summarily the taxpayer's argument that it was unfair to apply the 1958 regulation "retroactively" to an interest that had been created before the regulation was issued, finding that the taxpayer had no "right" that was "taken away" by the regulation. In rejecting the taxpayer's equitable arguments, the Court observed pointedly that the taxpayer made no argument that the taxation of disclaimers under the 1958 regulation is inconsistent with the statutory provisions imposing a gift tax, which were enacted before the creation of the trust in question. The Court also noted that the disclaimers in question were executed well after promulgation of the 1958 regulation.

The Supreme Court's decision in *Jewett* had the effect of resolving a number of pending gift and estate tax cases involving the interpretation of the 1958 regulation against the taxpayers and in favor of the Government. These taxpayers, and presumably others who wish to transfer their interests in pre-November 15, 1958 trusts without incurring gift taxes, are now seeking legislative relief from the Supreme Court's decision.

## PENDING LEGISLATION

Section 803 of the Senate amendment to H.R. 2163 would provide that the disclaimer of any interest created by a transfer prior to November 15, 1958, will be timely for estate and gift tax purposes if the disclaimer is made not later than 90 days after the bill's enactment. Similar legislation is contained in H.R. 2813, which has been introduced in the House but not passed. These bills would relieve the existing gift tax liabilities of taxpayers in the *Jewett* case and other pending cases controlled by that decision. The proposed legislation also would provide a 90-day "open season" to allow other beneficiaries of trusts created before November 15, 1958, to make tax-free transfers of property by disclaiming their interests in those trusts.

The primary argument being advanced in support of the proposed legislation is that the 1958 Treasury regulation unfairly deprived beneficiaries of pre-existing trusts of their right to make disclaimers of their contingent interests. The arguments in support of the legislation are essentially the same as the "equitable" arguments made by the taxpayer in the *Jewett* case.

## DISCUSSION

The Treasury Department strongly opposes H.R. 2813 and section 803 of the Senate amendment. The 1958 regulation is clearly a correct application of the gift tax statute to the disclaimers in question. The arguments advanced by the proponents of the legislation concerning the "retroactive" effect of the regulation were fully considered and rejected by the Supreme Court in *Jewett.* We believe that the Supreme Court's judgment was correct and should not be overridden by the Congress.

In essence, the pending legislation would grant retroactive private relief to a group of taxpayers who attempted to exploit what they and their advisers thought was a potential loophole in the gift tax law. Now that the Supreme Court has ruled that the loophole did not exist, Congress should not come to the rescue of these taxpayers by enacting retroactive private relief legislation.

It should be emphasized that the consequence of not acting legislatively in this case would be simply to leave the affected individuals in a situation where they made transfers of substantial value to the natural objects of their bounty and have to pay gift taxes on those transfers. Indeed, it is likely in most cases that the gift tax liabilities are considerably less than the estate taxes which eventually would have been payable had the disclaimers not been made. The taxpayers affected by the *Jewett* decision entered into "heads we win, tails we break even" transactions at worst. If their interpretation of the gift tax regulation had been sustained, they would have made transfers of substantial value to their children free from gift tax. The taxpayers took comfort in the fact that if the courts ultimately ruled against them, they still would save estate taxes by incurring lesser amounts of gift taxes in connection with the transfers. Thus, these disclaimer transactions clearly were attractive gambles.[1] We can see no reason why Congress ought now to give back the gift taxes these taxpayers have incurred through their aggressive tax planning.

We are troubled even more by the provision in the pending legislation which would open a 90-day window for tax-free transfers by beneficiaries of trusts established before November 15, 1958. Many of these individuals have known about these interests for decades and have treated them as part of their net wealth for purposes of financial and estate planning. To allow these individuals to "disclaim" these interests now would give them an unexpected and unwarranted windfall. If would also force estate planners to comb their files to ferret out all of the pre-November 15, 1958 interests which their clients could disclaim without tax consequences.

Before concluding, I would like to turn for a moment from the specific issue of disclaimers to the general question of whether Congress should provide retroactive relief for taxpayers adversely affected by Supreme Court decisions in tax cases. At the present time, Congress is considering relief not only in this case but also in *Dickman* v. *Commissioner,* 52 U.S.L.W. 4222 (1984), involving the gift tax consequences of interest-free loans, and in *Diedrich* v. *Commissioner,* 457 U.S. 191 (1982), involving the income tax consequences of net gifts of appreciated property. In all three of these cases, the taxpayers relied on favorable decisions of courts of appeal which were subsequently overturned by the Supreme Court. Each of these cases reached the Supreme Court only because a conflict developed between the circuits on the legal issue involved. If Congress grants relief in these cases, it would be sending a message that as soon as a court of appeals in one circuit decides an issue in favor of a taxpayer, other taxpayers with political influence can rely on the decision with impunity, secure in the knowledge that if the Supreme Court ultimately decides the issue against them, Congress will come to their rescue by granting retroactive relief.

This concludes my prepared remarks. I would be happy to answer your questions.

Chairman RANGEL. Mr. Woodward, your testimony makes it appear as though there are a small handful of wealthy taxpayers trying to avoid their tax liability; and if the administration is taking a position that proposes that, that is rather novel.

Mr. WOODWARD. Mr. Chairman, I will assure you that the administration and the Treasury Department have consistently opposed this legislation. We have testified against it on the Senate side. And I think that regardless of who is involved here it is a particularly troublesome example, to be sure; and I think we would share that concern reflected in your remark.

Chairman RANGEL. Is it your position that those that are seeking this legislative relief have taken this same question before the courts and that the courts have found that they have no case in law or in equity?

Mr. WOODWARD. Clearly, the Supreme Court did confront the equitable consideration and dealt with it in its opinion, rejecting the taxpayer's argument, although three of the nine Justices were persuaded by that.

But we see essentially no equity here. This was a contested matter. There is some superficial appeal to the claims made by taxpayers. But on close analysis, we don't agree with their view that there is any real equitable consideration in their favor.

Chairman RANGEL. How many petitioners did we have in the *Jewett* case?

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[1] In the *Jewett* case, the taxpayer disclaimed his trust interest years before it became fully vested. If the taxpayer had truly believed that the "reasonable time" period under the regulation began only when an interest became noncontingent, he would have had no reason to make his disclaimer prior to that time. The taxpayer also disclosed the transaction on his gift tax return. Thus, the facts in *Jewett* indicate that the taxpayer knew his disclaimer might be a taxable gift but decided to go forward, probably to avoid transfer taxes on the appreciation in value in the trust property after the date of the transaction.

Mr. **Woodward**. That case involved an appeal from the Ninth Circuit Court of Appeals involving only one taxpayer. There were a number of pending cases at that time in the lower courts, though, that were controlled by that case.

Chairman **Rangel**. How many people are we talking about, and how many dollars does the Treasury stand to lose under the bill?

Mr. **Woodward**. I think the number of taxpayers involved is in the range of 10 in the pending cases; the dollars involved are about $11 million of tax plus about an equal amount of interest—in view of the fact that these cases date from the early seventies—and a lot of interest has accrued.

Chairman **Rangel**. So it averages out to about $2 million a petitioner?

Mr. **Woodward**. Yes.

And I would also note that we can really not know what other taxpayers would be involved in the 90-day window aspect for future periods. We don't have any records of trusts that are in existence that might be passed down tax free under that provision. But we do believe that there could be some enormous trusts in the range of billions of dollars which could be transferred—probably skipping an additional generation in those cases—if this legislation were enacted with the window provision included.

Chairman **Rangel**. Mr. Conable.

Mr. **Conable**. Well, Mr. Woodward, I want to be sure I understand your position. First of all, you are not saying that the courts are always right, are you, or that legislatures are helpless in the face of court decisions?

Mr. **Woodward**. Absolutely not.

Mr. **Conable**. All right. I thank you for that.

Second of all, you are not saying that you are opposing this solely on fiscal grounds, are you?

Mr. **Woodward**. I think that, given the current budget deficits we would have a hard time in opposing solely on that basis. This is not going to be a significant item in that context.

Mr. **Conable**. So revenue impact is not driving your position?

Mr. **Woodward**. No, I think the revenue impact of this is the type of thing which certainly is not a basis for our decision at all. I think it is instructive to point out what is at stake because it illustrates the nature of the cases, but the dollar amount here would be one that should not carry the day.

That is not the basis on which we would have the decision made on the legislation.

Mr. **Conable**. However, you say that fiscal considerations are a great deterrent?

Mr. **Woodward**. In particular, the window aspect of the proposal. I think there could be some significant revenue consequences from the window aspect, but we really have no way of calculating that because we don't have the data.

Mr. **Conable**. Would your position be different if the window were not involved?

Mr. **Woodward**. Well, there certainly would be less of a revenue impact in the legislation. I think those who are in the position of not having gone forward with disclaimers because they knew there was a question involved would cry foul because those who went forward lost their cases and are now being rescued. There would be an obvious inequity between those two classes of taxpayers.

Mr. **Conable**. Well, I would like to suggest that there are some equitable considerations here that may be brought up in other testimony, beyond that which you are adducing. I have no further questions, Mr. Chairman.

Chairman **Rangel**. But it is your testimony that even if you didn't have the window that, as relates to sound tax policy, it would be wrong for us to legislate in this area after the court has ruled.

Mr. **Woodward**. That is correct, Mr. Chairman.

Chairman **Rangel**. Mr. Duncan.

Mr. **Duncan**. I have no questions. Thank you, Mr. Chairman.

Chairman **Rangel**. Thank you.

[The following was subsequently received:]

## JEWETT v. COMMISSIONER (455 U.S.305(1982)

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[¶ 13,453] George F. Jewett, Jr., et ux., Petitioners v. Commissioner of Internal Revenue.

Supreme Court of the United States, No. 80-1614, 2/23/82.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

*[Code Sec. 2511—See also Code Sec. 2518 with respect to post-1976 disclaimers]*

**Gift tax—Pre-1977 disclaimers—Timeliness—Remainder trust interest.—The taxpayer's 1972 disclaimers of his contingent remainder interest in a testamentary trust were taxable gifts because they were not executed within a reasonable time after the transfer of the interest to the taxpayer in 1939. Under applicable state law (Massachusetts), the disclaimers were valid because a beneficiary could disclaim a contingent remainder interest within a reasonable time after it vested in him, i. e., after the death of the life beneficiary, who was still alive in 1972. However, for federal gift tax purposes, the disclaimers were ineffective in preventing the completion of the gift because they were not made until 33 years after the interest was transferred to the taxpayer. Back references: ¶ 3200.79 and 8590.79.**

One dissent.

### Syllabus

*Held:* The "transfer" referred to in the Treasury Regulation excepting from the federal gift tax a refusal to accept ownership of an interest in property transferred by will if such refusal is effective under local law and made "within a reasonable time after knowledge of the existence of the transfer," occurs, as indicated by both the text and history of the Regulation, when the interest is created and not at a later time when the interest either vests or becomes possessory. Hence, in this case where disclaimers of a contingent interest in a testamentary trust, though effective under local law, were not made until 33 years, and thus not "within a reasonable time," after the interest was created, the disclaimers were subject to a gift tax under §§ 2501(a)(1) and 2511(a) of the Internal Revenue Code, as indirect gifts to a successor in interest. [80-2 USTC ¶ 13,384] 638 F. 2d 93, affirmed.

STEVENS, J., delivered the opinion of the Court, in which BURGER, C. J., and BRENNAN, WHITE, MARSHALL, and POWELL, JJ., joined. BLACKMUN, J., filed a dissenting opinion, in which REHNQUIST and O'CONNOR, JJ., joined.

James D. St. Clair, John G. Fabiano, Timothy H. Gailey, Christopher T. Carlson, Hale & Dorr, 60 State St., Boston, Mass. 02109, for George F. Jewett, Jr., and Lucille M. Jewett. Robert L. Stern, Howard M. McCue III, W. Steven Woodward, Mayer, Brown & Platt, 231 S. LaSalle St., Chicago, Ill. 60604, Robert A. Bergquist, Andrew W. Regan, Charles C. Parlin, Jr., Shearman & Sterling, 53 Wall St., New York, N. Y. 10005, for Coleman Burke, Wallace B. Liverance, Jr., Geoffrey J. O'Connor, Burke & Burke, 529 Fifth Ave., New York, N.Y. 10017, for amici curiae. Rex E. Lee, Solicitor General, John

F. Murray, Acting Assistant Attorney General, Stuart A. Smith, Assistant to Solicitor General, Jonathan S. Cohen, Karl P. Fryzel, Department of Justice, Washington, D. C. 20530, for respondent.

JUSTICE STEVENS delivered the opinion of the Court: A trust beneficiary's refusal to accept ownership of property may constitute an indirect gift to a successor in interest subject to federal gift tax liability. 26 U. S. C. §§ 2501, 2511. Under Treasury Regulation 25.2511-1(c), however, such a refusal is not subject to tax if it is effective under local law and made "within a reasonable time after knowledge of the existence of the transfer." The petitioner in this case executed disclaimers of a contingent interest in a testamentary trust 33 years after that interest was created, but while it was still contingent. The narrow question presented is whether the "transfer" referred to in the regulation occurs when the interest is created, as the Government contends, or at a later time when the interest either vests or becomes possessory, as argued by petitioner.

Petitioner's grandmother, Margaret Weyerhaeuser Jewett, died in 1939 leaving the bulk of her substantial estate in a testamentary trust. Her will, executed in Massachusetts, provided that the trust income should be paid to petitioner's grandfather during his life, and thereafter to his parents. Upon the death of the surviving parent, the principal was to be divided "into equal shares or trusts so that there shall be one share for each child of my said son [petitioner's father] then living and one share for the issue then living representing each child of my said son then dead." App. 9. Petitioner's mother is the sole surviving life tenant. Thus, under the testamentary plan, if petitioner survived his mother, he would receive one share of the corpus of the trust; if he predeceased his mother, that share would be distributed to his issue. Since petitioner's parents had two children, his share of the trust amounted to one-half of the principal.

In 1972, when petitioner was 45 years old, he executed two disclaimers. The disclaimers each recognized that petitioner had "an interest in fifty percent (50%) of the trust estate . . . provided that he survives" his mother. App. 15. In the first disclaimer, petitioner renounced his right to receive 95% "of the aforesaid fifty percent (50%) of the remainder of the trust estate," *ibid.*; in the second he renounced his right to the remaining five percent. In 1972 the value of the trust exceeded $8 million.

Petitioner and his wife filed gift tax returns for the third and fourth quarters of 1972 in which they advised the Commissioner of the disclaimers, but did not treat them as taxable gifts.[1] The Commissioner assessed a deficiency of approximately $750,000. He concluded that the disclaimers were indirect transfers of property by gift within the meaning of §§ 2501(a)(1)[2] and 2511(a)[3] of the Internal Revenue Code, and that they were not excepted from tax under Treas. Reg. 25.2511-1(c)[4] because they were not made "within a reasonable time after knowledge" of his grandmother's

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[1] Petitioner's wife, Lucille M. Jewett, elected to consent to treat the gifts made by her husband as having been made by both husband and wife to the extent allowed by law. App. to Pet. for Cert. A-20.

[2] "A tax, computed as provided in section 2502, is hereby imposed for each calendar quarter on the transfer of property by gift during such calendar quarter by any individual, resident or nonresident." 26 U. S. C. § 2501(a)(1).

[3] "Subject to the limitations contained in this chapter, the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; but in the case of a nonresident not a citizen of the United States, shall apply to a transfer only if the property is situated within the United States." 26 U. S. C. § 2511(a).

[4] "The gift tax also applies to gifts indirectly made. Thus, all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to tax. See further § 25.2512-8. Where the law governing the administration of the decedent's estate gives a beneficiary, heir, or next-of-kin a right to completely and unqualifiedly refuse to accept ownership of property transferred from a decedent (whether the transfer is effected by the decedent's will or by the law of descent and distribution of intestate property), a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocable [sic] and effective under the local law. There can be no refusal of ownership of property after its acceptance. Where the local law does not permit such a refusal, any disposition by the beneficiary, heir, or next-of-kin whereby ownership is transferred gratuitously to another constitutes the making of a gift by the beneficiary, heir, or next-of-kin. In any case where a refusal is purported to relate to only a part of the property, the determination of whether or not there has been a complete and unqualified refusal to accept ownership will depend on all of the facts and circumstances in each particular case.

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transfer to him of an interest in the trust estate. Petitioner then filed this action in the Tax Court to recover the deficiency.

In the Tax Court and in the Court of Appeals, petitioner argued that at the time the disclaimers were made he had nothing more than a contingent interest in the trust, and that the "reasonable time" in which a tax-free disclaimer could be made did not begin to run until the interest became vested and possessory upon the death of the last surviving life tenant.[5] Although a comparable argument had been accepted by the Court of Appeals for the Eighth Circuit in *Keinath v. Commissioner of Internal Revenue* [73-1 USTC ¶ 12,928], 480 F. 2d 57 (1973),[6] it was rejected by the Tax Court[7] and by the Ninth Circuit[8] in this case. We granted certiorari to resolve the conflict. — U. S. —.

Petitioner relies heavily on the plain language of the Treasury Regulation and on early decisions that influenced its draftsmen. Before analyzing that language and its history, it is appropriate to review the statutory provisions that the regulation interprets.

I. Section 2501(a)(1) of the Internal Revenue Code imposes a tax "on the transfer of property by gift." Section 2511(a) provides that the tax shall apply "whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible." As the Senate[9] and House[10] Reports explain:

> "The terms 'property,' 'transfer,' 'gift,' and 'indirectly' are used in the broadest and most comprehensive sense; the term 'property' reaching every species of right or interest protected by law and having an exchangeable value."

In *Smith v. Shaughnessy* [43-1 USTC ¶ 10,013], 318 U. S. 176, 180, the Court noted that "[t]he language of the gift tax statute, 'property . . . real or personal, tangible or intangible,' is broad enough to include property, however conceptual or contingent."

Our expansive reading of the statutory language in *Smith* unquestionably encompasses an indirect transfer, effected by means of a disclaimer, of a contingent future interest in a trust.[11] Congress enacted the gift tax as a "corollary" or "supplement" to the estate tax.[12] In *Estate of Sanford v. Commissioner* [39-2 USTC ¶ 9745], 308 U. S 39, 44, the Court explained that "[a]n important, if not the main, purpose of the gift tax was to prevent or compensate for avoidance of death taxes by taxing the gifts of property *inter vivos* which but for the gifts, would be subject in its original or converted form to the tax laid upon transfers at death." Since the practical effect of

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taking into account the recognition and effectiveness of such a purported refusal under the local law. In the absence of facts to the contrary, if a person fails to refuse to accept a transfer to him of ownership of a decedent's property within a reasonable time after learning of the existence of the transfer, he will be presumed to have accepted the property. In illustration, if Blackacre was devised to A under the decedent's will (which also provided that all lapsed legacies and devises shall go to B, the residuary beneficiary), and under local law A could refuse to accept ownership in which case title would be considered as never having passed to A. A's refusal to accept Blackacre within a reasonable time of learning of the devise will not constitute the making of a gift by A to B. However, if a decedent who owned Greenacre died intestate with C and D as his only heirs, and under local law the heir of an intestate cannot, by refusal to accept, prevent himself from becoming an owner of intestate property, any gratuitous disposition by C (by whatever term it is known) whereby he gives up his ownership of a portion of Greenacre and D acquires the whole thereof constitutes the making of a gift by C to D." Treas. Reg. 25.2511-1(c); 26 CFR 25.2511-1(c) (1981).

[5] As did the Tax Court, we assume that petitioner's interest in the trust is properly characterized as a contingent remainder. Although that interest is arguably a vested remainder subject to divestiture, the distinction is not one of substance for our purposes here. Cf. *Helvering v. Hallock* [40-1 USTC ¶ 9208], 309 U. S. 106.

[6] In *Keinath*, the court applied "the prevailing common law rule" and held that the holder of a vested remainder interest subject to divestiture has a reasonable time after the death of the life beneficiary within which to renounce or disclaim the remainder without tax consequences. 480 F. 2d, at 64. The court emphasized that the holder of the remainder interest did not obtain a right to beneficial ownership and control of the property until the death of the life beneficiary. *Ibid.*

[7] 70 T. C. 430 (1978).

[8] 638 F. 2d 93 (CA9 1980).

[9] S. Rep. No. 665, 72d Cong., 1st Sess. 39 (1932).

[10] H. R. Rep. No. 708, 72d Cong., 1st Sess. 27 (1932).

[11] The actual value of the interest will be affected by the fact that it is not indefeasibly vested. As the Tax Court noted in this case:

"The value of petitioner's remainder interest was not, of course, equal to 50 percent of the value of the trust corpus. Rather, it depended upon actuarial factors reflecting the various contingencies." 70 T. C., at 435 n. 3.

[12] The Committee Reports state that the gift tax was designed

"to impose a tax which measurably approaches the estate tax which would have been payable on the donor's death had the gifts not been made and the property given had constituted his estate at his death. The tax will reach gifts not reached, for one reason or another, by the estate tax." H. R. Rep. No. 708, 72d Cong., 1st Sess. 28 (1932); S. Rep. No. 655, 72d Cong., 1st Sess. 40 (1932).

petitioner's disclaimers was to reduce the expected size of his taxable estate and to confer a gratuitous benefit upon the natural objects of his bounty, the treatment of the disclaimers as taxable gifts is fully consistent with the basic purpose of the statutory scheme.

II. The controlling Treasury Regulation provides that a refusal to accept ownership of property transferred from a decedent does not constitute a gift if two conditions are met. First, ① the refusal must be effective under the law governing the administration of the decedent's estate. Second, ② the refusal must be made "within a reasonable time after knowledge of the existence of the transfer."

There is no dispute in this case that the first requirement has been satisfied; the disclaimers were effective under Massachusetts law. The controversy arises from the second requirement; specifically, it is over the meaning of the word "transfer," which may be read to refer to the creation of petitioner's remainder interest by his grandmother's will, or to either the vesting of that interest or the distribution of tangible assets upon the death of the life tenant. Both positions find support in the language of the regulation.

To a layman the word "transfer" would normally describe a change in ownership of an existing interest rather than the creation of a new interest. Moreover, the reference to a transfer of "ownership of a decedent's property" suggests that the transferee must acquire property that once had been owned by the decedent; petitioner's grandmother never owned the future interests that her will created, but she once did own the assets (or their equivalent) that the remaindermen will acquire when their interests become possessory in character. Thus, language in the regulation implies that the relevant "transfer" had not yet occurred when petitioner renounced his interest in the trust.

Other language, however, indicates that the relevant "transfer" occurs at the time of the testator's death. The word "transfer" is the basic term used in the gift tax provisions to describe any passage of property without consideration that may have tax consequences. See 26 U. S. C. §§ 2501, 2511, *supra*, nn. 2, 3.[illegible] The regulation describes a transfer that "is effected by the decedent's will" (or by the law of descent and distribution of intestate property), not by a subsequent vesting event or distribution of property. The property must be transferred "from a decedent," not from an estate executor or trust administrator. The lack of any reference in the regulation to future interests or contingent remainders, and the consistent focus on transfers effected by the decedent by will or through the laws of intestate distribution, undermines the suggestion that the relevant transfer occurs other than at the time of the testator's death. The regulation also requires "knowledge of the existence of the transfer"; since a person to whom assets have actually been distributed would seldom, if ever, lack knowledge of the existence of such a transfer, it seems more likely that this provision was drafted to protect persons who had no knowledge of the creation of an interest.

On balance, we believe that the text of the regulation supports the Commissioner's interpretation. Because that text is not entirely clear, however, it is appropriate to examine briefly the regulation's history.

III. Treas. Reg. 25.2511-1(c) has not been changed since it was promulgated on November 15, 1958. The form of the regulation, however, is somewhat different from a draft that was first proposed on January 3, 1957. That draft required a renunciation to be made "within a reasonable time after knowledge of the existence of the interest," rather than after knowledge of the existence of the "transfer."[illegible]

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[illegible] Petitioner does not contend that the creation of an irrevocable trust for the benefit of alternate contingent remaindermen is not a "transfer" when made; if the creation of such a trust is a "transfer" of property within the meaning of the statute, a "transfer" occurred in this case at Margaret Weyerhaeuser Jewett's death. In short, the use of the word "transfer" in Treas. Reg. 25.2511-1(c) is not indicative of special meaning. To the contrary, Congress has specifically indicated that the term "transfer," at least as used in the statutory provisions defining the gift tax, is used "in the broadest and most comprehensive sense." See p. 5, *supra*, and nn. 9, 10. It is not surprising that the draftsmen of the regulation would choose the general term utilized by Congress to describe any passage of property with possible tax consequences.

[illegible] The January 3, 1957 draft of the regulation provided, in part:

"The renunciation of a vested property interest, such as the interest of an heir or next-of-kin, or devisee in whom title immediately vests upon a decedent's death under local law, constitutes a gift to those persons who receive the property interest by means of the renunciation. On the other hand the renunciation of a gift, bequest, or inheritance, if under local law title does not immediately vest, is not a gift if the renunciation is complete, and is made within a reasonable time after knowledge of the existance of the interest." 22 Fed. Reg. 58 (1957).

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The word "interest" unquestionably would encompass a contingent remainder even if the word "transfer" arguably would not. Thus, if the initial draft had been adopted without change, petitioner's disclaimers certainly would be subject to tax. Petitioner contends that the drafting change must have been intended to avoid this consequence.

An assessment of petitioner's argument requires an examination of the reason for the change in the regulation's language. The explanation of the change rendered by the Commissioner in 1958 indicates that it was intended to accomplish a purpose quite different from that suggested by petitioner.

A Memorandum from the Commissioner to the Secretary of the Treasury submitted on October 1, 1958 explained that the change in language was intended to capture "the proper distinction" between two early court decisions that the regulation had attempted to codify.[14] In both of these cases the transferee had renounced a fee interest before the administration of the decedent's estate had been completed. In the earlier case, *Brown v. Routzahn*, 63 F. 2d 914 (CA6 1933), cert. den. 290 U. S. 641, a husband refused to accept a bequest under his wife's will. Under Ohio law the disclaimer was effective because it preceded the distribution of his wife's estate. Since the husband had never acquired ownership of the property, his disclaimer was held not to constitute the transfer of an interest; rather, it was deemed an exercise of a right to refuse a gift of property. Accordingly, the renunciation was held not to be a gift in contemplation of death for purposes of determining the husband's estate tax. In the second case, *Hardenbergh v. Commissioner of Internal Revenue* [52-2 USTC ¶ 10,859], 198 F. 2d 63 (CA8 1952), cert. den. 344 U. S. 836, the decedent died intestate leaving a wife, a daughter, and a son by a prior marriage. To effectuate the decedent's intent to equalize the wealth of the three, the wife and daughter relinquished their rights to their intestate shares.

Under Minnesota law, however, "title to an interest in decedent's estate vested in the taxpayers by operation of law which neither had the power to prevent." 198 F. 2d, at 66. Since local law denied them the power to renounce the interest, the taxpayers' disclaimers were not effective and constituted gifts subject to the federal gift tax.

As indicated in the Commissioner's Memorandum, Treas. Reg. 25.2511-1(c) sought to preserve the distinction between these two cases. Originally, the regulation tracked language in the *Hardenbergh* opinion and provided that a disclaimer was taxable only if title to the property had "vested" under state law. On consideration, however, the Commissioner recognized that this language did not capture "the proper distinction between these two court cases"; indeed, in *Brown v. Routzahn*, the property interest had fully "vested" at the time of the taxpayer's renunciation.[15] Thus, to incorporate the proper distinction, the Commissioner changed the "vesting" requirement to a requirement that " the law governing the administration of the decedent's estate" must give a right to "refuse to accept ownership of property transferred from a decedent." Having eliminated the "vested property interest" language from the first part of the regulation, the Commissioner correspondingly changed the second part to read "within a reasonable time after knowledge of the existence of the transfer," rather than "within a reasonable time after knowledge of the existence of the interest."

Thus, the purpose of the change in the regulation was not to exclude contingent remainders. Neither *Brown* nor *Hardenbergh* concerned contingent interests. Since the original draft of the regulation supports the government's position in this case, and since the change in its form was made for a reason that is unrelated to the issue presented, the regulation's history buttresses the government's position.

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[14] The Memorandum is published in XIII *Tax Notes* 203 (July 27, 1981). In pertinent part, the Memorandum explains:

"In what was intended to be the application of the rules in *Brown v. Routzahn* (1933) 63 F. 2d 914, cert. denied 290 U. S. 641, and *Hardenbergh v. Commissioner* [52-1 USTC ¶ 10,859] (1952) 198 F. 2d 63, cert. denied 344 U. S. 836, it was stated that where title to the property did not vest in the beneficiary or heir immediately upon the decedent's death, the renunciation of the property did not constitute the making of a gift, but that where title vested in the beneficiary or heir immediately upon the decedent's death, the act of the bneeficiary or heir in giving up what passed to him from the decedent constituted the making of a gift. . . . Protests on these provisions were received. After reviewing these protests, we have reconsidered our position and now believe that the proper distinction between these two court cases turns on the question of whether under the applicable State law a beneficiary or heir can or cannot refuse to accept ownership of the property which passed from the decedent. Accordingly, we have revised paragraph (c) of section 25.2511-1 to reflect this change of position."

[15] As the court stated in that case:

"The [taxpayer] was in possession of the estate from 1912 until it was transferred to the trustees in 1920. It was not, however, in his possession as donee, but as a coexecutor. Nevertheless, at any time within that period he could have taken the one-third or made a renunciation that would have estopped him from claiming it. He did neither. It may be conceded, too, we think, that, had he died at any time between 1912 and the date of the distribution, this property would have passed under a general devise in his will, or, leaving no will, would have passed under the laws of descent and distribution as a part of his estate." 63 F. 2d, at 916.

Petitioner also contends that the history of the regulation demonstrates that its draftsmen merely intended to codify the rules of *Brown v Routzahn* and *Hardenbergh v. Commissioner*, and that under those cases state law controlled both the "right" to renounce and the "timeliness" of the renunciation. Although petitioner accurately interprets these two cases, his interpretation of the regulation would render half of it superfluous. The regulation explicitly imposes two requirements: (1) the disclaimer must be effective as a matter of local law; and (2) the disclaimer must be made within a reasonable time. If timeliness were governed solely by local law, the second requirement would be redundant. While it is possible that local law may require a disclaimer to be timely to be effective, such a requirement would not absolve the taxpayer from the separate timeliness requirement imposed by the federal regulation. Otherwise, the regulation would be complete with a single requirement that the disclaimer be effective under local law.[illegible]

IV. Petitioner's remaining arguments may be answered quickly. In the Tax Reform Act of 1976, Congress established specific standards for determining whether a disclaimer constitutes a taxable gift; those new standards would support the Commissioner's position in this case if the disclaimers had been executed after the effective date of the Act.[illegible] Petitioner argues that the legislative decision not to apply those standards retroactively is evidence that a different rule was previously effective. It is clear, however, that Congress expressed no opinion on the proper interpretation of the regulation at issue in this case; it merely established an unambiguous rule that should apply in the future.[illegible]

Petitioner also argues that it is unfair to apply the 1958 regulation "retroactively" to an interest that had been created previously; petitioner asserts that, by the time the regulation was adopted, it was already too late—according to the Commissioner's view—to disclaim the interest.[illegible] The argument lacks merit. It is based on an assumption that petitioner had a "right" to renounce the interest without tax consequences that was "taken away" by the 1958 regulation. Petitioner never had such a right. Indeed, petitioner does not argue that taxation of the disclaimers is inconsistent with the statutory provisions imposing a gift tax, which were enacted long before petitioner's interest in the trust was created. The 1958 regulation was adopted well in advance of the disclaimers in this case; we see no "retroactivity" problem.

Finally, petitioner argues that the disclaimer of a contingent remainder is not a taxable event by analogizing it to an exercise of a special power of appointment, which generally is not considered a taxable

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[illegible] It is possible that the federal timeliness requirement was added in response to the particular facts presented by *Brown v. Routzahn*, *supra*, in which the taxpayer waited eight years to renounce the interest and did so when he was 72 years old. Although the renunciation was timely as a matter of Ohio law, the Treasury Department may well have thought that such delay was unacceptable for federal tax purposes. In practical effect, the eight year delay made it likely that the renunciation decision was part of the taxpayer's personal estate planning. As explained by the Tax Court in this case:

> "While a State court might be willing to accept a renunciation of a nonpossessory and not indefeasibly vested property interest after the passage of considerable time, so long as the interests of third parties have not been harmed, the passage of time is crucial to the scheme of the gift tax. With time, the potential recipient can wait to see if he himself needs the property, or whether he had better let it pass directly to the next generation." 70 T. C., at 437.

[illegible] See Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1893, § 2009(b); 26 U. S. C. § 2518(b).

[illegible] After noting the decision in *Keinath v. Commissioner of Internal Revenue* [73-1 USTC ¶ 12,929], 480 F. 2d 57 (CA-8 1973), and the "reasonable" time requirement of the regulation, the House Report states that Congress

> "believe[d] that definitive rules concerning disclaimers should be provided for estate and gift tax purposes to achieve uniform treatment. In addition, [Congress] believe[d] that a uniform standard should be provided for determining the time within which a disclaimer must be made." H. R. Rep. No. 1380, 94th Cong., 2d Sess. 66-67 (1976).

Nothing in the legislative history expresses an opinion on the proper interpretation of the previously controlling regulation. Nor is such an opinion indicated by the mere enactment of the law: Congress may seek to clarify the future without affecting the past. Cf. *Knetsch v. United States* [60-2 USTC ¶ 9785], 364 U. S. 361, 367-370.

[illegible] Petitioner's argument would have more appeal had he attempted to renounce the interest immediately *after* the adoption of the 1958 regulation, rather than some 14 years later.

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transfer. 26 U. S. C. § 2514. As the Commissioner notes in response, however, a disclaimant's control over property more closely resembles a *general* power of appointment, the exercise of which is a taxable transfer. *Ibid.* Unlike the holder of a special power—but like the holder of a general power—a disclaimant may decide to retain the interest himself. It is this characteristic of the control exercised by a disclaimant that makes a disclaimer a "transfer" within the scope of the gift tax provisions.

V. The Commissioner's interpretation of the regulation has been consistent over the years and is entitled to respect. This canon of construction, which generally applies to the Commissioner's interpretation of the Internal Revenue Code, see *Commissioner v. Portland Cement Co. of Utah*, 450 U. S. 156, 169, is even more forceful when applied to the Commissioner's interpretation of his own regulation.

Since the relevant "transfer" in this case occurred when petitioner's grandmother irrevocably transferred her assets to a testamentary trust, petitioner's disclaimers of the rights created by that trust were not made within a reasonable time. Even accepting petitioner's argument that the clock did not begin to run until he reached the age of majority, the disclaimers were made after the passage of 24 years. As the Tax Court explained:

> "The petitioner possessed, for 24 years, the effective right to determine who should ultimately receive the benefits of a 50-percent remainder interest of a trust which, in 1972, had a corpus of approximately $8 million. He waited to act in respect of that remainder interest until the surviving life beneficiary was over 70 years of age and until he himself was 45 and, it appears, a man of substantial means. In 1972, by the execution of two disclaimers, he elected to let the property pass according to the alternative provisions of his grandmother's will—to the natural objects of his bounty. This, we hold, was an exercise of control over the disposition of property subject to the gift tax imposed by section 2501." 70 T. C., at 438 (footnote omitted).

We agree. The Commissioner's assessment of a tax was proper, both under the statute and the regulation.

The judgment of the Court of Appeals is affirmed.

## Dissenting Opinion

JUSTICE BLACKMUN, with whom JUSTICE REHNQUIST and JUSTICE O'CONNOR join, dissenting: I do not find this case as easy or as clear on behalf of the Government as a reading of the Court's opinion would lead one to believe. While the issue could be described as somewhat close, I conclude that the petitioners have much the better of the argument, and I would reverse the judgment of the Court of Appeals.

I. Margaret Weyerhaeuser Jewett, grandmother of petitioner George F. Jewett, Jr., died testate on January 14, 1939. At her death she was a resident of Massachusetts. She left a will which was duly admitted to probate in that Commonwealth.

By her will the decedent created a trust for the benefit of her husband, James R. Jewett, during his lifetime, and thereafter for the benefit of her son, George F. Jewett, and his wife, Mary, for their respective lives. On the death of the survivor of the three life beneficiaries, the trust estate is to be distributed to the then living children of George F. Jewett and to the then living issue of any deceased child of George F. Jewett, in equal shares by right of representation.

Petitioner George F. Jewett, Jr., was born April 10, 1927; he thus was not yet 12 years old when his grandmother died. The testatrix' husband, James, and her son, George, died prior to 1972. Mary is still living; she was born March 7, 1901.

On August 30, 1972, petitioner[1] executed an instrument disclaiming and renouncing the major portion of any right to receive any remainder of the trust estate upon the death of his mother. On December 14 of that year, petitioner executed a second instrument disclaiming and renouncing the remaining portion of any such right. It is undisputed that these 1972 disclaimers were valid, timely, and effective under the applicable Massachusetts law.

Petitioner George F. Jewett, Jr., and his wife, petitioner Lucille M. Jewett, filed federal gift tax returns for the calendar quarters ended September 30 and December 31, 1972, respectively. Those returns notified respondent Commissioner of the disclaimers but did not acknowledge them as taxable transfers for federal gift tax purposes.[2]

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[1] For convenience, any reference made herein to "petitioner" in the singular, refers to George F. Jewett, Jr., alone.

[2] Petitioners, as they were entitled to do under § 2513 of the Internal Revenue Code of 1954, 26 U. S. C. § 2513, elected to treat any gift made by either as made equally by both.

On audit, the Commissioner determined that the disclaimers were *not* "made within a reasonable time after knowledge of the existence of the transfer," within the meaning of Treas. Reg. § 25.2511-1(c), 26 CFR § 25.2511-1(c) (1981), and thus were transfers subject to federal gift tax under §§ 2501(a)(1) and 2511(a) of the Internal Revenue Code of 1954, as amended. 26 U. S. C. § 2501(a)(1) and 2511(a). Deficiencies of approximately $750,000 were determined.

Petitioners sought redetermination of the deficiencies in the United State Tax Court. That court, in a reviewed decision, ruled in favor of the Commissioner. 70 T. C. 430 (1978). In so doing, the court followed its earlier ruling in *Keinath v. Commissioner* [CCH Dec. 31,394], 58 T. C. 352 (1972), an unreviewed decision that had been *reversed*, [73-1 USTC ¶ 12,928] 480 F. 2d 57 (1973), by a unanimous panel of the United States Court of Appeals for the Eighth Circuit five years before. In the present case, a panel of the Ninth Circuit, by a divided vote, *affirmed* the Tax Court. 638 F. 2d 93 (1980). Because of the conflict so created, between judgments of two Courts of Appeals, the case is here.

II. As the Court observes, *ante*, at 6, the language of the regulation provides support for the petitioners as well as for the Commissioner. The Court also acknowledges that the regulation has language that "implies that the relevant 'transfer' had not yet occurred when petitioner renounced his interest in the trust." *Ibid.* The Court, however, opts for the Commissioner's opposing interpretation. I am persuaded otherwise.

To be sure, certain factors lend colorable support to the Commissioner's position: (a) Although petitioner was not yet 12 years old when the testatrix died, he attained the age of 21 in 1948, 24 years before he executed the disclaimers in 1972. (b) Sections 2501(a)(1) and 2511(a) of the Code are broad and sweeping and were intended to reach every "transfer of property by gift," whether in trust or otherwise, and whether direct or indirect. (c) And to accept petitioners' position could mean, as a practical matter, that one who is a beneficiary of a trust, such as this testatrix created, may stand aside for a long period before disclaiming and thus, in a sense, may make that disclaimer a part of his own estate planning when actual possessory enjoyment of the property is nearer at hand and its desirability or a need for it is better evaluated than many years before.

The other side of the controversy, however, is not without substantial support. The federal gift tax does not deal with abstractions. It is concerned with "the transfer of property by gift." 26 U. S. C. § 2501(a)(1). With the development of testamentary trusts—or, for that matter, of *inter vivos* trusts—legally recognized "interests" of various kinds, possessory and anticipatory, can be created by the trustor. The beneficiary of a contingent remainder or, as the Court seems to suggest here, *ante*, at 4, n. 5, of "a vested remainder subject to divestiture," however, may never realize anything by way of actual enjoyment of income or corpus. The contingencies upon which enjoyment depends may never ripen. In particular, the contingent beneficiary may die while the life beneficiary still lives.

These possibilities, accompanied by the monetary impact of gift and death taxes led courts and legislative bodies to recognize or develop common-law disclaimer and to enact preventive statutory provisions. Indeed, the Commissioner here, in the regulation at issue, § 25.2511-1(c), recognizes a right to refuse, free of gift tax, acceptance of "ownership of property transferred from a decedent," provided that the right to refuse is effective under local law and the refusal is "made within a reasonable time after knowledge of the existence of the transfer." It is accepted that the disclaimers in the present case were effective under Massachusetts law. I search the statute in vain, however, for any statutory mention of, or provision for, the reasonable time requirement. One might say, therefore, that the Commissioner in his wisdom acted as a matter of grace to relieve, upon the conditions specified, what could be difficult and potentially unfair and financially disastrous tax situations.

Be that as it may, I regard any "transfer" here, not as one from George F. Jewett, Jr. (the necessary predicate of the Commissioner's determination), but as a transfer from the testatrix. She is the one from whom the largess flows. Petitioner, of course, was in the line of designated beneficiaries, but he stepped from that line through the acts of disclaimer, and the transfer will pass him by.

There are other practical considerations that have appeal for me:

1. Accepting the Commissioner's regulation and its "reasonable time" require-

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[Dissenting Opinion]

ment, it seems to me that that time is to be measured, not from the death of the testatrix in 1939, but from the death of the preceding life beneficiary. That life beneficiary, petitioner's mother, is still alive. Petitioner has realized no benefit from the trust and never will have any benefit if he predeceases his mother. It is the contingency event that is important and makes sense in the consideration of any disclaimer.

2. A disclaimer is fundamentally different from a voluntary transfer of property. A disclaimer is a refusal to accept property *ab initio*. *Bel v. United States* [72-1 USTC ¶ 12,818], 452 F. 2d 683, 693 (CA5 1971), cert. denied, 406 U. S. 919 (1972); see Black's Law Dictionary 417 (5th ed., 1979). The law of disclaimer is founded on the basic property-law concepts that a transfer is not complete until its acceptance by the recipient, and that no person can be forced to accept property against his will. A transferor chooses the recipients of the transferred property; a disclaimant makes no such selection, for that selection has been made by the trustor. Petitioner's disclaimers merely renounced any future right to receive corpus of the trust; they did not direct or even purport to direct the future distribution of that corpus.

3. Until the Ninth Circuit, by its divided vote, decided the present case, the only Court of Appeals authority on the issue was *Keinath v. Commissioner, supra*. For reasons best known to it, the Government did not seek certiorari in that case and the decision stood unmolested by any opposing appellate court authority for over seven years. Indeed, it was expressly reaffirmed by the Eighth Circuit sitting en banc in *Cottrell v. Commissioner* [80-2 USTC ¶ 13,369], 628 F. 2d 1127 (1980), a case decided just a few weeks before the Ninth Circuit decision.[3] In the interim, a substantial period as the tax law goes, taxpayers and their advisors have properly assumed that a disclaimer, valid under state law, was valid for federal tax purposes as well if it were timely made. Judge Harris, dissenting below, observed that "it is particularly important in matters of taxation that established precedent be followed." 638 F. 2d, at 96. He went on to say that if the case were one of first impression, he "might well join with the majority" but "[n]umerous tax practitioners have undoubtedly relied on this [the *Keinath*] opinion in advising as to the tax consequences of such acts as are involved in the instant case, and justifiable so." *Ibid.* I agree that stability in tax law is desirable. Except for the Tax Court, the pronounced law appeared to have achieved a level of stability after *Keinath*.

4. The Eighth Circuit's analysis of the legal issue, it seems to me, is sound. In *Keinath* the court stressed that the remainder beneficiary "at no time accepted any income or principal from the trust," 480 F. 2d, at 59, and that within eight weeks of the death of the testator's widow-life beneficiary, the remainderman executed his disclaimer. It was established that the disclaimer was valid and timely under applicable state law and that as a result thereof the trust estate passed to the disclaimant's children. The Court noted that "reasonable time," as that term is used in the regulation, is not defined either in the Code or the regulation. The basic common-law requirements that the disclaimer must be made within a reasonable time and that it be effective under local law "are but a codification of common law principles applicable to the doctrine of disclaimers." *Id.*, at 61. A central factor is the interpretation of the word "transfer" in the regulation. The remainderman "had really nothing to accept or renounce by way of beneficial ownership or control of the property until he succeeded in outliving the life beneficiary." *Id.*, at 64. The court then held that, under the prevailing common law, the holder of a vested remainder interest subjected to divestiture has a reasonable time within which to disclaim after the death of the life beneficiary. *Ibid.* It distinguished *Fuller v. Commissioner* [CCH Dec. 25,106], 37 T. C. 147 (1961), upon which the Tax Court had relied, and did so on the factual grounds mentioned below.

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[3] In *Cottrell*, three judges dissented because they felt that, in contrast with the factual situation in *Keinath*, the *Cottrell* taxpayer had "extensive" and "ultimate" control through a general testamentary power of appointment. They would modify the *Keinath* approach "where the remainderman essentially controls the events which would cause divestiture of the interest." They agreed, however, with the "general rule as applied to the facts of *Keinath*," where an interest is "less than an indefeasibly vested remainder." 628 F. 2d, at 1132-1133.

It is of interest to note that the court in *Cottrell* observed: "The Commissioner has not asked us to overrule *Keinath*, and we are not inclined to do so on our own motion." *Id.*, at 1131.

In *Cottrell*, the Eighth Circuit, sitting en banc, adhered to its *Keinath* analysis. It felt the case was "indistinguishable in any material respect from *Keinath*," 628 F. 2d at 1128. It was undisputed that the disclaimer in question was valid under state law, that is was unequivocal, and that the taxpayer accepted no property before she disclaimed. As in *Keinath*, if the "reasonable time" period began with the death of the testator, the disclaimer was untimely, but if the critical event was the death of the life beneficiary, the disclaimer "was unquestionably timely, having been executed 16 days, and filed two months, thereafter." 628 F. 2d, at 1129. There is nothing unfair or improper in allowing the remainderman to wait until the life beneficiary's death and then decide whether to accept the bequest.

What the Eighth Circuit said by way of analysis, and held, in *Keinath* and *Cottrell*, when applied to the facts before us, is persuasive and should control here. The Ninth Circuit majority, without any particular analysis, merely disagreed with the *Keinath* and *Cottrell* reasoning and held, in a conclusionary statement, that the " 'transfer' as used in the regulation means the transfer to the disclaimant of the property interest disclaimed by him," and that the transfer in question took place in 1939 when Mrs. Jewett died and petitioner received a contingent remainder from her estate. 638 F. 2d, at 96.

5. The Court notes, *ante*, at 12, that by the Tax Reform Act of 1976, Pub. L. 94-455, § 2009(b)(1), 26 U. S. C. § 2518, Congress now has imposed a uniform tax treatment of disclaimers, independent of state law. Section 2518, as so added to the Code, however, was specifically made prospective only, that is, it was made applicable only to transfers creating an interest after 1976. Pub. L. 94-455, § 2009(e)(2), 90 Stat. 1896. It thus has no application to the present case.

The Court declares, *ante*, at 12: "Congress expressed no opinion on the proper interpretation of the regulation at issue in this case," but merely established an unambiguous rule for the future. That conclusion is not at all clear to me. Congress was aware of the *Keinath* decision. See H. R. Rep. No. 94-1380, p. 66 and n. 4 (1976). The House Committee on Ways and Means observed:

> "The amendments apply with respect to transfers creating an interest in the person disclaiming made after December 31, 1976. In the case of transfers made before January 1, 1977, the rules relating to transfers under present law, including the period within which a disclaimer must be made, are to continue to apply to disclaimers made after December 31, 1976." *Id.*, at 67-68.

For me, this is an acknowledgement that the *Keinath* ruling represented what the law was prior to 1977, and what it still is for trust instruments effective before that calendar year. I cannot join the Court's flat statement that "Congress expressed no opinion" on the existing law.

6. To be sure, the Tax Court has persisted in its contrary rulings. Those rulings, I feel, rest on an insecure base. The original case, from which all the other Tax Court decisions have flowed, was *Fuller v. Commissioner* [CCH Dec. 25,106], 37 T. C. 147 (1961), a reviewed case. In *Fuller*, the life beneficiary of five-eighths of the income of her husband's testamentary trust received that income for many years before she renounced a portion of her five eighths share. Thus, she realized actual enjoyment for a long period before she disclaimed. This, for me, is a vital fact that distinguishes the case from *Keinath*, *Cottrell*, and *Jewett*, where each disclaimant enjoyed no benefit whatsoever. Mrs. Fuller had accepted her gift before renouncing it.

The next Tax Court case was *Keinath v. Commissioner* [CCH Dec. 31,394], 58 T. C. 352 (1972). The judge who decided *Keinath* relied on *Fuller* as controlling precedent. He acknowledged Mrs. Fuller's receipt of income from the trust "for over 25 years," conceded that the Fuller facts "are admittedly different," but nevertheless ruled that "this distinction is immaterial." 58 T. C., at 358. He did not read *Fuller* "as resting upon Mrs. Fuller's acceptance of income from the trust but upon her acceptance of her interest in the trust." *Ibid.*

The next pertinent Tax Court decision was that in the present case.[*] 70 T. C. 430 (1978). There the court, in a reviewed decision, referred to, and relied upon, its own decision in *Keinath* which had been

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[*] See, however, *Estate of Rolin v. Commissioner* [CCH Dec. 34,637], 68 T. C. 919, 927 (1977), aff'd, 588 F. 2d 368 (CA2 1978).

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reversed by the Eighth Circuit. "We think that our decision in *Keinath* was correct and that it controls the decision in this case." 70 T. C., at 435.

The last Tax Court cases are *Estate of Halbach v. Commissioner* [CCH Dec. 35,517], 71 T. C. 141 (1978), and *Cottrell v. Commissioner* [CCH Dec. 36,132], 72 T. C. 489 (1979). The former was a federal estate tax case centering on 26 U. S. C. § 2035 (disclaimer within three years of death). The latter, concerning a sister of the *Halbach* decedent, related to federal gift tax. Neither was a reviewed decision. The judge in *Cottrell*, recognizing that that case was appealable only to the Eighth Circuit, avoided the Court of Appeals decision in *Keinath* by distinguishing it on grounds later found unacceptable by the Eighth Circuit majority when the Tax Court decision was reversed.

Such is the saga of the issue in the United States Tax Court. The cases build on one another, but the origin and base is *Fuller*. That original case, in my view, is clearly distinguishable on its facts and thus, indeed, is a "frail reed on which to lean."

7. The Court's and the Government's position also seems to me to embrace a distinct element of unfairness. The Commissioner stresses repeatedly the number of years that elapsed between the death of the testatrix and the execution of the disclaimers. This same element has been stressed in others of these cases. But to require the disclaimer long before the interest could ripen into enjoyment means that the decision must be made at a time when the disclaimant does not know what he is disclaiming or whether he ever would receive and enjoy any interest. This concern is compatible with the wording of the applicable regulation which speaks of "knowledge of the existence of the transfer." The Eighth Circuit recognized this element of unfairness in *Cottrell*. 628 F. 2d, at 1131.

For all these reasons, I would reverse the judgment of the Court of Appeals. I therefore respectfully dissent.

Chairman **Rangel**. Mr. Gutman, Professor Gutman, University of Virginia, former Deputy Tax Legislative Counsel with Treasury.

## STATEMENT OF HARRY L. GUTMAN, ASSOCIATE PROFESSOR OF LAW, UNIVERSITY OF VIRGINIA SCHOOL OF LAW, FORMER DEPUTY TAX LEGISLATIVE COUNSEL, DEPARTMENT OF THE TREASURY

Mr. **Gutman**. Thank you, Mr. Chairman.

Chairman **Rangel**. You have heard the testimony of Tax Legislative Counsel Woodward, Professor. Your entire written testimony will be entered into the record without objection.

You may feel you want to highlight that testimony for us.

Mr. **Gutman**. Thank you, Mr. Chairman. I will do that.

H.R. 2813, as Mr. Woodward has said, and as the hearing notice makes clear, would have the effect of retroactively reversing the Supreme Court decision in *Jewett* v. *United States* but only with respect to interests that were created by property transfers which occurred prior to November 15, 1959, the effective date of the gift tax regulations in question.

In my judgment the bill should not be enacted. It provides unwarranted tax relief for a restricted class of taxpayers and sets a dangerous precedent with respect to the proper role of the courts and Congress in the administrative process.

I think it might be useful to have a little background on the general issue of disclaimers.

A disclaimer is a refusal to accept a proffer of property or an interest in property. The gift tax issue raised by a disclaimer is whether the disclaiming party, the disclaimant, should be treated as having accepted the proffered property or interest and subsequently transferred it to the person who ultimately receives that property or the interest as a result of the disclaimer.

Transfer tax law has for a long time recognized that a timely and unequivocal refusal to accept property or an interest in property should not be treated as an acceptance and reconveyance by the person who has refused the interest.

If a grandfather says to his son, here is $1 million and the son says, I don't want it, and then the grandfather gives that $1 million to his grandson, the son's refusal to accept the $1 million and the grandfather's subsequent transfer of that amount to the grandson is not treated as a gift from the grandfather to the son, followed by a gift from the son to the grandson.

This result follows from the fact that the transfer tax is imposed on transfers of interests in property and, in the example, the son had never received an interest in the property given to the grandson; moreover, the son had no control over that $1 million once he refused it.

Now, the principle that a person may refuse to accept an interest in property without gift tax consequences has also been applied to interests created by transfers in trust even though, and this is important, in the case of transfers of interests to trusts, the disclaimant does have an element of control over who is going to receive the disclaimed interest.

For example, if that same grandfather instead transferred $1 million to a trust in which the income was going to be payable to his wife for life and he gave his son the power to withdraw the principal whenever he wanted and whatever was left in the trust at the son's death would go to the grandson; that is a different kind of situation.

Suppose the son immediately notifies the trustee that he doesn't want his power to withdraw corpus. The son knows that by refusing to accept his interest in the trust the entire corpus is going to go to the grandson at the death of the grantor's wife. In this sense, the son has control over the disposition of the corpus. If he desired the corpus to go elsewhere, he would instead accept the power, withdraw the corpus and transfer it as he wished. His failure to accept the interest, even if it is done very early, can be viewed as a transfer of the property by him to his son. Yet treating the refusal to accept as a transfer of the corpus would be viewed by many people as odd because it would transform the son's attempt to defeat a gift to him as a gift by him.

The law has reconciled this conflict by permitting the son to refuse his power without transfer tax consequences provided that refusal was made within a reasonable time after the creation of the interest and the son had not exercised the power prior to the refusal.

So far, we have talked about situations in which the donee has a present right to the transferred property. Suppose instead that what the grandfather does is transfer $1 million to a trust to pay income to his wife for life, then to distribute the principal to his son or if the son predeceased his wife, to his grandson.

In this example the son has received an interest in the trust the moment it was funded. He has the right to the corpus if he survives his mother. Unlike the prior example, he doesn't have any immediate right to trust corpus but just like the prior example he does have an element of control over the trust corpus. He can, by refusing to accept his remainder interest, cause the trust corpus to be paid to the grandson upon the death of the mother.

If the son refuses his remainder interest immediately after the creation of the trust most would conclude that he should not be treated as making an indirect gift. But suppose, instead, he waits for 33 years and then while his mother is still alive he notifies the trustee that he doesn't want his remainder interest. For 33 years he has possessed an interest in that trust. If during that time he had conveyed the interest to, for example, his sister, he would have made a taxable gift of the value of the interest at that time even though, by the way, he didn't yet possess any trust property.

Should his refusal to accept the interest 33 years after he has received it when that refusal has the effect of transferring the remainder to the grandson be treated as a gift? That is what the *Jewett* litigation was all about. And the proponents of this legislation are asking you to answer that question "no" if the trust had been created prior to 1958 even though the Supreme Court has answered "yes."

Disclaimers of interests in trusts inevitably create tensions in the transfer tax. I have previously noted that one could take the position that any disclaimer of an interest in a trust should constitute a taxable gift. On this theory, if a disclaimer of a future interest in a trust is treated as a nontransfer a disclaimant is allowed to make a nontaxable gift to the next taker.

It is very important to recognize this consequence. This is what the estate planning in these cases is all about. If all disclaimers of future interests are accorded nontransfer status, holders of the future interests may with impunity avoid the transfer tax attributable to the conveyance of those valuable property rights when those rights are going to the persons who in most cases are the natural objects of their bounty. By so doing, one layer of transfer tax is avoided. This potential erosion of the transfer tax base can be cured. It does not require that all disclaimers be treated as taxable gifts by the disclaimant, but it does require that some time limit, consistent with the notion that a disclaimer is an unqualified refusal to accept property or an interest in property, be imposed on the right to refuse a future interest in property.

Mr. Chairman, the proponents of this legislation have principally based their case on what I consider to be an erroneous view of the state of the law at the time the disclaimers that they are engaged in took place.

I would like to state for you what I think a careful lawyer would have done in 1958, after promulgation of the regulations, with respect to the advice he would render a client if the client came in and said, "Look, I have a future interest in a trust that was created a long time ago. I haven't done anything with it yet. Tell me, can I disclaim it now, get the trust property to my children without the payment of any transfer tax?"

To answer that question, we would have to look at the state of the law at that time. Now, we know that prior to 1977 the Internal Revenue Code did not contain any provision defining when a disclaimer would be effective for transfer tax purposes. In the regulations we had regulation §25.2511-1(c), the object of the inquiry here, which had been promulgated in 1958. It provided, as we know, that a refusal to accept property doesn't constitute the making of a gift so long as that refusal is made within a reasonable time after knowledge of the existence of the transfer.

Once that regulation was promulgated, of course, the question that is presented by it is: What is the transfer? Is it the transfer that creates the initial interest in the disclaimant or the transfer of property to the disclaimant when the future interest becomes possessory?

In its proposed form, the regulation had different language. It had said that a refusal had to be made within a reasonable time after the disclaimant had knowledge of the existence of the interest and, of course, had that language been contained in the final regulations the answer would have been absolutely clear.

That, unfortunately, did not happen. So, what would this careful lawyer do if he was asked in 1958 and before 1977 what transfer tax consequences attended this disclaimer?

Well, I think any careful lawyer would first look to see whether under the 1939 code there were any regulations at all dealing with disclaimers or renunciations. If he had done that, he would have found a regulation. Now, admittedly, that regulation had to do with the renunciation of a power of appointment, but nonetheless it was a specific regulation dealing with when the renunciation of a power of appointment was going to be effective.

If he looked at that regulation, he would see that in substance that regulation required that a disclaimer of a power of appointment would be effective only if that disclaimer was first of all valid under local law, and second, an additional requirement, made within a reasonable time of learning of the existence of the power.

Well, the next thing I suppose he would do is look at the case law. If he did that prior to 1961, he would find only two cases dealing with renunciations. And both of them dealt with renunciations of outright testamentary transfers, so he wouldn't get any guidance with respect to what happens if he tries to disclaim a future interest.

However, if he was asked this question after 1961, he would have a Tax Court case to look at. Presumably his search would have turned up the case of *Fuller* v. *Commissioner,* which held that attempted disclaimer made in 1956 of an income interest for life created by a will probated in 1931 was not made within a reasonable time even though that disclaimer was effective under the local law.

Of course, if he were asked this question in 1974, then he would have found *Keinath* v. *Commissioner. Keinath* was the first case dealing specifically with the interpretation of the word "transfer" in connection with the determination of when a reasonable time to disclaim began. The Tax Court in *Keinath*—this seems to be conspicuously absent in the proponent's statement of *Keinath*—had held for the Government and the eighth circuit had reversed.

Another thing he would do is look at the secondary sources to see if any commentators had mentioned this problem with respect to disclaimers. I don't think he would find any help from commentators in the periodicals on the specific question of whether the transfer occurred at the time of the transfer or when the interest became possessory. But if he took a look at one of the leading treatises in the areas, Mertens, he would find in the 1959 edition a flat statement, without any further comment, that a refusal to accept property must be made within a reasonable time after knowledge of existence of the transfer.

Well, what would he conclude? First, I think it was clear even prior to 1955 that the effectiveness of the disclaimer for transfer tax purposes did not turn solely on the question whether that disclaimer was valid under State law. This conclusion is directly contrary to a principal premise of the proponents of this bill.

Second, a leading treatise took the position that a future interest had to be disclaimed within a reasonable time of the transfer creating that interest. In the face of this authority—and I hasten to add without any explicit guidance from the IRS or the courts—it is difficult for me to believe that our careful lawyer would advise a client that the post-1958 disclaimer of a future interest created prior to 1955 was going to be effective for Federal tax purposes so long as that disclaimer was effective for State law purposes.

You have heard from Mr. Woodward the arguments made to the Supreme Court. One of the arguments the taxpayers made to the Supreme Court was that it was somehow unfair to apply this 1958 regulation to them. As Mr. Woodward said, the Court flatly rejected that argument.

In the words of the Court:

> The argument was based on an assumption that petitioner had a right to renounce the interest without tax consequences that was taken away by the 1958 regulation. Petitioner never had such right. The 1958 regulation was adopted well in advance of the disclaimers in this case, and we see no retroactivity.

That is what the Supreme Court said.

Despite this statement, this legislation has been pressed before you on the ground that the 1958 regulation somehow changed the rules in the middle of the game. It is alleged that prior to the promulgation of the 1958 regulation the law had been clear that a disclaimer was not subject to gift tax so long as it was effective under applicable law. Proceeding from this assertion, the proponents argue that it would have been impossible in 1958 to disclaim a future interest in a trust created more than a reasonable time prior to that date. And accordingly, they assert, in what has to be a monumental leap of logic, that any taxpayer today who possesses a future interest in property transferred to a trust prior to November 15, 1958, ought now to be accorded the opportunity to relinquish that interest tax free.

I believe that the basic premise of the proponent's argument is false. The regulations in existence under the 1939 code flatly contradict it. What is really happening here is that the proponents are attempting to reargue before you the case they lost in the Supreme Court. The witnesses you are going to hear from may make appealing arguments, but you should recognize in at least one of those cases, the case of the *Estate of Helen W. Hallbach,* the issue was litigated in the Tax Court and the taxpayer lost.

In fact, there are other facets of that case, Mr. Chairman, that might make the taxpayer's argument even more difficult if the case even were to be relitigated. In that case, although the Tax Court did not make much of it, the taxpayer had possessed a general power of appointment which she cut down to a special power of appointment in 1945, and the taxpayer had also been the recipient of a modest interest-free loan from the trustee well before the taxpayer disclaimed the interest. It seems to me that if this case were argued on the merits it would certainly be possible to assert that the taxpayer had accepted the benefits of the interest prior to the disclaimer, and once that happens, you cannot make an effective disclaimer.

In addition to that, I think you ought to take notice of the fact that there are at least eight other cases that have been brought to the committee's attention—I have six in my testimony, but I have since learned of two others—in which attempted disclaimers were made in 1974, a magic year, the year after the eighth circuit decided the *Keinath* case.

A taxpayer who disclaimed a pre-1958 interest after *Keinath,* it seems to me, took a calculated but in one sense very low-risk gamble. That taxpayer was on notice that the Tax Court disagreed with the position he was going to take. But that taxpayer could, if he was detected on audit—of course you play the audit lottery first or maybe not even put the disclaimer on a gift tax return—litigate the issue in a district court. If he lost there, or even if he went to the Tax Court and lost, he could appeal to another circuit court in the hope it would adopt the position of the eighth circuit.

It is interesting to note, at least with respect to one of these 1974 disclaimers, the taxpayer lived in Connecticut. After making the disclaimer but before filing a petition in the Tax Court, the taxpayer moved to Minnesota in the eighth circuit, to litigate the case. If the law was so clear, one wonders why that happened.

Even if the taxpayer lost the case all the way through, as an estate planning matter, as Mr. Woodward pointed out, he was in pretty good shape. The property was going to go to the person that he otherwise would have given it to. The gift at the time of the ineffective disclaimer would have been the value of the interest at that time. What that meant was that all the posttransfer appreciation in the property would be out of his transfer tax base. The gift would be subject to tax at the then separate gift tax rates that at all levels were 75 percent of the estate tax rates and, of course, the gift tax base is the value of the gift with no tax imposed on the gift tax.

Now, inter vivos gifts of large amounts were a commonly recommended estate planning technique prior to the 1976 Tax Act. While one doesn't know for sure, it certainly is possible that the disclaimants in these cases would have transferred these interests even if they knew gift tax liability would result. The very act of disclaimer shows they had no need for the property subject to the future interest. Under these assumptions, the disclaimer is a "no lose" proposition. If it is treated as a gift, the taxpayer is no worse off than if he actually transferred the interest. If it is not, he has managed to pass substantial property to the object of his bounty, without the imposition of a transfer tax.

If H.R. 2813 is enacted, not only will the taxpayers who disclaimed pre-1958 interests prior to the *Jewett* decision be relieved of their transfer tax liability, but also any taxpayer who today possesses a future interest in a pre-1958 trust will be accorded a similar opportunity. Mr. Chairman, that is an estate planning bonanza. In the name of "fairness," those who didn't disclaim prior to the *Jewett* decision—perhaps because their counsel had advised that a disclaimer under those circumstances was in fact a taxable gift—are going to be afforded a second chance to make substantial tax-free transfers.

Mr. Woodward has also spoken to you about the precedential consequences with respect to the administration of the tax laws that would occur if this type of legislation and that in *Dickman* and *Diedrich* are enacted. I want to associate myself with his views. In my statement I also come to a similar conclusion.

In conclusion, I would just like to say that the Tax Court has consistently upheld the Commissioner's position on this issue. It simply doesn't make sense to say that careful advisers were unaware of the state of the law. I think what has happened here is that a number of taxpayers attempted to take advantage of one circuit court of appeals decision. When they were audited, they litigated—that is what the courts are for. They lost in the Tax Court. Then one taxpayer lost in a different court of appeals, and that taxpayer lost in the Supreme Court. Now, similarly situated taxpayers are coming before you to ask for retroactive relief. I think this is precisely the kind of activity that Congress ought to discourage rather than encourage, and I see no basis either in equity or in sound tax policy for granting them the relief they seek.

Thank you, Mr. Chairman, and I will be happy to answer any questions you might have.

[The prepared statement follows:]

### STATEMENT OF HARRY L. GUTMAN, ASSOCIATE PROFESSOR, UNIVERSITY OF VIRGINIA SCHOOL OF LAW

Mr. Chairman and members of the subcommittee: My name is Harry Gutman. I am Associate Professor of Law at the University of Virginia and served as Deputy Tax Legislative Counsel during the last administration. I am honored to appear before you today as an invited witness to present my views on the substance of and the policy issues raised by H.R. 2813.

H.R. 2813, which is substantively identical to section 803 of the Deficit Reduction Tax Bill of 1984 passed by the Senate, would treat the disclaimer of an interest created by a transfer of property made before November 15, 1958 as a "qualified disclaimer" so long as the requirements of section 2518(b) (1), (3) and (4) are met and the disclaimer is made within 90 days following enactment. The bill would have the effect of retroactively reversing the Supreme Court decision in *Jewett* v. *United States*, 455 U.S. 305 (1982), but only with respect to interests created by property transfers occurring before November 15, 1958.

H.R. 2813 should not be enacted. It provides unwarranted tax relief for a restricted class of taxpayers and sets a dangerous precedent with respect to the proper role of the courts and Congress in the administration of our tax laws.[1]

#### BACKGROUND

A disclaimer (or renunciation) is a refusal to accept a proffer of property or an interest in property. The gift tax issue raised by a disclaimer is whether the disclaiming party (the "disclaimant") should be treated as having accepted the proffered property or interest and subsequently transferred it to the person or persons who ultimately receive the property or interest as a result of the disclaimer.

Transfer tax law has long recognized that a timely, unequivocal refusal to accept property or an interest in property should not be treated as an acceptance and reconveyance by the party who has refused the interest. Thus, for example, if a grandfather says to his son, "Here is $1,000,000," the son says "I don't want it" and the grandfather gives the $1,000,000 to his grandson, the son's refusal to accept the $1,000,000 and the grandfather's subsequent transfer of that amount to the grandson is not treated as a gift from the grandfather to the son followed by a second gift from the son to the grandson. This result follows from the fact that the transfer tax is imposed upon transfers of interests in property and, in the example, the son never received an interest in property given to the grandson. Note also, the son had no control over the $1,000,000 once he refused it.

The principle that a person may refuse to accept an interest in property without gift tax consequences has also been applied to interests created by transfers in trust even though, in that case, the disclaimant does have an element of control over who will receive the disclaimed interest. For example, assume a grandfather transferred $1,000,000 to a trust in which the income was payable to his wife for life, his son was granted the power to withdraw principal as he desired, and whatever was left in the trust at the son's death would pass to his grandson. The son immediately notifies the trustee that he refuses to accept his power to withdraw trust corpus. The son knows that by refusing to accept his interest in the trust, the entire corpus will pass to the grandson at the death of the wife. In this sense, the son has control over the disposition of the trust corpus. If he desired the corpus to go elsewhere he would instead accept the power, withdraw corpus, and transfer it as he wished. Consequently, his failure to accept the interest can be viewed as a transfer of the property by him to the grandson. Yet, treating the refusal to accept as a transfer of the corpus could be viewed as odd because it would transform the son's attempt to defeat the gift *to him* as a gift *by him*. The law has reconciled this conflict by permitting the son to refuse his power without transfer tax consequences provided the refusal was made within a reasonable time of the creation of the interest and the son had not exercised the power prior to the refusal.

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[1] Moreover, if enacted in its current form, the bill would apply unevenly among taxpayers for whom relief is apparently intended. Any taxpayer who disclaimed a future interest, paid gift tax and as to whom the statute of limitations has expired, will not get relief under the bill. The bill could be amended to permit such taxpayers to apply for refunds, but this would add an administrative burden on the Internal Revenue Service.

Thus far I have dealt only with situations in which the donee has a present right to the transferred property. Suppose, instead, that the grandfather transfers $1,000,000 to a trust to pay the income to his wife for life, then to distribute the principal to his son or, if his son had predeceased his wife, to his grandson. In this example the son receives an interest in the trust at the moment it is funded; the right to the corpus if he survives his mother. Unlike the prior example he has no immediate right to trust corpus. However, like the prior example, he has an element of control over the trust corpus. He can, by refusing to accept his remainder interest, cause the trust corpus to be paid to the grandson upon the death of the mother. If the son refuses his remainder interest immediately after the creation of the trust, most would conclude that he should not be treated as making a gift. But suppose instead he waits for 33 years and then, while his mother is still alive, he notifies the trustee that he is renouncing his remainder interest. For 33 years he has possessed an interest in the trust. If, during that time, he had conveyed that interest to, for example, his sister, he would have made a taxable gift of the value of the interest (even though he did not yet possess the trust property). Should his refusal to accept the interest 33 years after he received it, when that refusal has the effect of transferring the remainder to the grandson, be treated as a gift? That is what the *Jewett* litigation was about. The proponents of this legislation are asking you to answer "no" if the trust had been created prior to 1958 even though the Supreme Court has answered "yes."

Disclaimers of interests in trusts inevitably create a tension in the transfer tax. As the foregoing examples illustrate, a disclaimant of a trust interest always knows where the disclaimed interest will go. The trust instrument provides the answer. By that standard, any disclaimer of a trust interest could be viewed as transfer by the disclaimant to the next taker. After all, if the disclaimant was not satisfied with the person who would get the interest if he disclaimed, he could simply convey the interest to the person he wanted to get it (in which case he would make a taxable gift) or he could do nothing and receive the property (in which case the property would be included in his transfer tax base). If a disclaimer of a future interest in a trust is treated as a non-transfer, a disclaimant is, under this analysis, allowed to make a non-taxable gift to the next taker. It is important to recognize this consequence. If all disclaimers of future interests are accorded non-transfer status, holders of future interests may, with impunity, avoid the transfer tax attributable to the conveyance of those valuable property rights to the persons entitled to succeed the disclaimants, and one layer of transfer tax is avoided. Curing this potential erosion of the transfer tax base does not require that all disclaimers of future interests be treated as taxable gifts by the disclaimant. But it does require that some time limit, consistent with the notion that a disclaimer is an unqualified refusal to accept property or an interest in property, be imposed upon the right to refuse a future interest in property.

## THE LAW PRIOR TO JEWETT

Prior to 1977 the Internal Revenue Code did not contain any provision defining when a disclaimer would be effective for transfer tax purposes.[2] However, Regulations, § 25.2511-1(c), promulgated on November 14, 1958, provided that "a refusal to accept property does not constitute the making of a gift if the refusal is made within a *reasonable time after knowledge of existence of the transfer.*" (Emphasis added.) The issue presented by this language, in the context of a future interest in a trust, was whether the "transfer" in question was the transfer creating the initial interest in the disclaimant or the transfer of property to the disclaimant when the future interest became possessory.

In proposed form, Reg., § 25.2511-1(c), had required that a refusal be made within a reasonable time after knowledge of the existence of the "interest." Had the final Regulation contained the same language, the answer would have been clear. However, as it did not, the Regulation, on its face, was ambiguous. Moreover, Reg., § 25.2511-1(c), was "applicable to gifts made during calendar year 1955 and subsequent calendar years." 1958-2 C.B. 627.

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[2] Section 2518(b)(2), enacted in 1976, requires that a disclaimer be made no later than 9 months after the later of the transfer creating the interest in a disclaimant or the date the disclaimant reaches age 21.

What then would a careful lawyer do if, after 1958 and before 1977, he was asked what transfer tax consequences resulted from the disclaimer of a future interest in a trust that had been created prior to 1955? I suppose he would first look to see whether any Regulations under the 1939 Code dealt with disclaimers. This search would reveal Regulations 105, § 81.24(b)(2)(iii), dealing with disclaimers of powers of appointment. That Regulation stated in substance that a disclaimer of a power would be effective only if the disclaimer was both valid under local law and made within a reasonable time of learning of the power.

He would next survey the case law. If he did so prior to 1961 he would find only two cases dealing with renunciations and both of them dealt with the renunciation of outright testamentary transfers.[3] Not much help there. However, if he did so after 1961, he would have found *Fuller* v. *Commissioner,* 37 T.C. 147 (1961), which held that an attempted disclaimer made in 1956 of an income interest for life created by a will probated in 1931 was not made within a reasonable time *even though the disclaimer was effective under local law.* If he were asked the question in 1974, he would also have found *Keinath* v. *Commissioner,* 58 T.C. 352 (1971), reversed 480 F. 2d 57 (8th Cir. 1973). *Keinath* was the first case dealing specifically with the interpretation of the word "transfer" in connection with determining when the "reasonable time" to disclaim began. The Tax Code had held that the transfer that started the time period running was the transfer creating the interest in the disclaimant. The Eighth Circuit reversed.

He could next examine the secondary sources. He would find no help from commentors in periodicals on the specific question whether the "transfer" occurred at the date of the transfer creating the future interest or when the future interest became possessory.[4] However, an examination of federal tax treatises would the answer he was looking for. The 1959 edition of Mertens, "Law of Federal Gift and Estate Taxation" at page 81 stated flatly, and without further comment, that a refusal to accept property must be made within a reasonable time "after knowledge of the *existence of the interest.*"

What, then, would the lawyer conclude? First, it was clear, even prior to 1955, that the effectiveness of a disclaimer for transfer tax purposes did not turn solely on whether the disclaimer was valid under local law. Second, a leading treatise took the position that a future interest had to be disclaimed within a reasonable time of the transfer creating the interest. In the face of this authority, and without any explicit guidance from the Internal Revenue Service or the courts, it is difficult to believe that our careful lawyer would advise a client that the post 1958 disclaimer of a future interest created prior to 1955 would be effective for federal tax purposes so long as it was effective for state law purposes. Moreover, if the lawyer were asked the question after 1961, he would surely be even more cautious as the *Fuller* case explicitly rejected the proposition that state law controlled the federal tax issue. Finally, if he were asked the question after 1973, he would advise that if the case is litigated in the Tax Court and appeal lay to any Circuit other than the 8th Circuit, the Tax Court would most probably conclude that the disclaimer was a taxable gift.[5]

### THE JEWETT CASE

In *Jewett,* a contingent remainder disclaimed in 1972 his remainder interest in a trust 33 years after the trust was created (24 years after he reach majority) but before the interest became possessory. The disclaimer was valid under local law. The Commissioner asserted that, notwithstanding, the disclaimer constituted a taxable gift because the disclaimer was not made within a reasonable time from the date the taxpayer had knowledge of the existence of his interest in the trust. The taxpayer argued that the time period should commence when the interest became possessory—e.g., upon the death cf the life tenant.

The Supreme Court held that the transfer occurred when the trust was created, and that measured from that date, the taxpayer's disclaimer was not timely. In so holding, and this is critical to the issue before the Subcommittee, the Court flatly rejected the taxpayer's argument that the application of Reg., § 25.2511-1(c), to post 1958 disclaimers of interests created prior to 1958 was "unfair." In the words of the Court, the argument "is based on an assumption that petitioner had a 'right' to renounce the interest without tax consequences that was 'taken away' by 1958 regulation. Petitioner never had such a right. . . . The 1958 regulation was adopted well in advance of the disclaimer in this case; we see no retroactivity problem."

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[3] *Brown* v. *Routzahn,* 63 F.2d 914 (6th Cir. 1933) and *Hardenburgh* v. *Commissioner,* 198 F.2d 63 (8th Cir. 1952).

[4] There was, however, recognition of the fact that a disclaimer would not be effective for transfer tax purposes simply because it was effective for state law purposes. See Sayles, Renunciations—Estate and Gift Tax Problems, 1953 U.S.C. Tax Inst. 531, 538. "While the Bureau adopts the principle that no invalid renunciation will escape transfer tax, there are indications that it may reject the corollary that no effective renunciation will be subjected to tax."

[5] This may explain why Lois P. Cottrell, a resident of Stonington, Connecticut, when she disclaimed a future interest in a trust, established residence in Excelsior, Minnesota (in the 8th Circuit) prior to filing a petition in the Tax Court to contest the Commissioner's assertion that her disclaimer was a taxable gift. *Cottrell* v. *Commissioner,* 72 T.C. 489, 490 (1979).

### H.R. 2813

Despite this square rejection of the "unfairness" argument, H.R. 2813 has been pressed on the ground that the 1958 regulation changed the rules in the middle of the game. It is alleged that prior to the promulgation of the 1958 regulation "the law had been clear that a disclaimer was not subject to gift tax so long as it was effective under applicable law." Proceeding from this assertion, the proponents argue that it would have been impossible, even in 1958, to disclaim a future interest in a trust created more than a "reasonable time" prior to that date. Accordingly, they assert, in a monumental leap of logic, that any taxpayer who possesses a future interest in property transferred to a trust prior to November 15, 1958 ought now to be afforded the opportunity to relinquish that interest tax-free.

As I have already shown, the basic premise of the proponent's argument is false. Regulations in existence under the 1939 Code flatly contradict it. What is really happening is that the proponents are attempting to re-argue, before the Congress, the case they lost in the Supreme Court.

The witnesses you will hear from may make appealing arguments. But you should recognize that at least in the case of the Estate of Helen W. Halbach, the issue was decided in 1978 by the Tax Court against the taxpayer. And you should also take note of the fact that there are at least six other cases that have been brought to your attention in which attempted disclaimers of interests created prior to 1958 were made in 1974—after the *Keinath* case was decided by the 8th Circuit.

A taxpayer disclaiming a pre-1958 interest after the *Keinath* decision took a calculated, but in one sense low risk, gamble. Although on notice that the Tax Court disagreed, the taxpayer could, if detected on audit, litigate the issue in a District Court and if he lost there (or in the Tax Court) appeal to another Circuit Court in the hope it would adopt the position of the 8th Circuit. But even if the taxpayer lost the case, as an estate planning matter he was still in good shape. First, the property subject to the interest would go to the person to whom he would otherwise have given it. Second, the gift at the time of the ineffective disclaimer would be equal to the value of the future interest at the date of the transfer. All post-transfer increases in the value of the interest (attributable both to the passage of time and appreciation of trust assets) would be removed from his transfer tax base. Finally, the gift would be taxed at the then separate gift tax rates, which were 75% of the estate tax rates for a transfer of a comparable amount.

Inter vivos gifts of large amounts were a commonly recommended estate planning technique prior to the Tax Reform Act of 1976. While one doesn't know for sure, it is certainly possible that the disclaimants in these cases would have transferred these interests even if they knew gift tax liability would result. The very act of disclaimer shows they had no need for the property subject to the future interest. Under these assumptions, the disclaimer is a "no lose" proposition. If it is treated as a gift, the taxpayer is no worse off than if he actually transferred the interest. If it is not, he has managed to pass substantial property to another without the imposition of a transfer tax.

If H.R. 2813 is enacted, not only will the taxpayers who disclaimed pre-1958 interests prior to the *Jewett* decision be relieved of their transfer tax liability, but also any taxpayer who today possesses a future interest in a pre-1958 trust will be accorded a similar opportunity. What an estate planning bonanza for wealthy individuals in this position! In the name of "fairness" they will be afforded a second chance to make substantial tax-free transfers they did not make earlier—perhaps because their counsel had advised that a disclaimer under such circumstances was a taxable gift!

### TAX ADMINISTRATION

The attempt to reverse retroactively the Supreme Court decision in *Jewett* for a limited class of taxpayers raises a serious issue of tax administration. And it is, unfortunately, an issue that has been raised increasingly in recent years. On April 4, 1984, the Senate Finance Committee held a hearing on the question whether the Supreme Court's decision in *Dickman* v. *Commissioner*, holding that interest-free demand loans are taxable gifts to the extent of the foregone interest, should be reversed retroactively for loans made prior to the date of the decision. At that time Senator Dole stated his concern with the implications of this form of relief legislation. If such legislation were enacted, "Taxpayers and their tax advisors would soon realize that the audit lottery could be played under a new set of rules. Not only could aggressive taxpayers feel confident that their chances of being audited were less than 2 percent but taxpayers would be further emboldened by the thought that even if they were audited, they could litigate; even if they litigated and lost they could appeal; and even if the Supreme Court upheld the Internal Revenue Service, the Congress could be counted on to forgive their tax liability."

Former Commissioner Jerome Kurtz reiterated the point made by Senator Dole. "To reverse the result in *Dickman* would be to undermine the more careful and conservative tax advisors and taxpayers for the benefit of those who act more aggressively. Such precedents do serious damage to tax administration. . . . Legislation should not be enacted which would give taxpayers who entered into these transactions and who knew or should have known of the risks involved the benefit of taking those risks. It should be recognized that during this period there are taxpayers who did not enter into transactions of this kind because they correctly recognized that they would be subject to tax. The tax system cannot function by rewarding the aggressive over the conservative; by rewarding those who were wrong over those who were right."

And finally, Stuart A. Smith, formerly Tax Assistant to the Solicitor General in the Department of Justice and now in private practice, echoed the same theme. "From my perspective as both a former government official and a private practitioner, I believe that retroactive legislative relief has a generally negative effect on the administration of the tax laws."

### CONCLUSION

To be sure, extraordinary circumstances may exist where proper tax administration requires that a decision of the Supreme Court be applied in a prospective manner only. But like *Dickman,* the issue addressed by this legislation presents no such extraordinary circumstances. Transfer tax avoidance opportunities abound if taxpayers are permitted to wait for 20 or 30 years to see whether it is appropriate to accept possession of property subject to a future interest.

You will hear today from proponents whose cases seem superficially appealing. But in all probability you will not hear about at least six disclaimers that were made in the year after the *Keinath* decision. if the law was so clear prior to the *Keinath* decision, why did those taxpayers wait until after that decision to disclaim? Why did one taxpayer who executed a disclaimer prior to the *Keinath* decision nominally move to Minnesota (in the 8th Circuit) before filing a petition in the Tax Court?

The Tax Court consistently upheld the Commissioner's position on this issue. It simply does not make sense to say that careful advisors were unaware of the state of the law. Rather, what happened was that a number of taxpayers attempted to take advantage of one Court of Appeals decision. When they were audited, they litigated the issue. They lost in the Tax Court. Then one taxpayer lost in a different Court of Appeals. Then that taxpayer lost in the Supreme Court. Now, similarly situated taxpayers come to you asking for retroactive relief. This is precisely the type of activity Congress ought to discourage rather than encourage. There is no basis either in equity or in sound tax policy for granting the relief they seek.

I will be pleased to answer any questions you may have.

Chairman RANGEL. Are you characterizing this legislation before this committee as being special vested interest relief?

Mr. GUTMAN. Yes, sir.

Chairman RANGEL. Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman. Thank you, Mr. Gutman.

Prior to the promulgation of the regulations in 1958, did you consider the law sufficiently clear as to when a taxpayer must act to disclaim an interest in property for Federal tax purposes?

Mr. GUTMAN. Well, sufficiently clear is a difficult proposition, a difficult thing to deal with, Mr. Duncan. I don't think the law was clear. I would be the first to say that the law was not particularly clear with respect to what the absolute requirements were. I think we can distinguish between two different types of situations: First, in the case of an outright transfer of property, I think it was clear, based at least on the power of appointment regulation, that a disclaimer in order to be valid had to be made in a timely fashion. That was certainly clear.

As far as I am aware, there is absolutely no authority in existence at the time of the promulgation of the 1958 regulation, other than the Treasury's language in the proposed regulation promulgated in 1957, dealing with when the reasonable time from which to disclaim a future interest began. I don't think that question was clear.

Mr. DUNCAN. There were no rules to be guided by; is that correct?

Mr. GUTMAN. There were no rules to be guided by with respect to the future interest. But I want to point out——

Mr. DUNCAN. Do you think there should have been?

Mr. GUTMAN. Do I think there should have been? There had been commentaries written in 1950 in the Vanderbilt and Harvard Law Reviews urging more clarity. Yes, there should have been. I definitely believe there should have been.

But notice the people arguing for this legislation are not arguing the law was uncertain, they are arguing the law was absolutely clear. I just don't think that is right.

Mr. DUNCAN. And IRS did not take its current position until 1972. Do you not think that was a long time coming?

Mr. GUTMAN. I also quarrel with that, because I am not sure that that is an accurate reading of things. The IRS litigated and won the *Fuller* case in 1961. To be sure, that case involved different facts. There the taxpayer had had an income interest in the property and she sought to disclaim that income interest many years after she had received it by a disclaimer that was effective under State law. The Tax Court held that that was an ineffective disclaimer for Federal tax purposes. That decision can be rationalized on two grounds, first that the taxpayer had accepted the benefits prior to the renunciation, in which case it is not a valid disclaimer, but also the Tax Court was very clear that the disclaimer was made after a reasonable time from the creation of the interest had expired.

When the *Keinath* case was litigated, the Tax Court specifically relied on *Fuller,* the 1961 decision, for the proposition that the reasonable time period begins to run from the creation of the interest. So I do not think it is quite fair to say that the Service never publicly took a position prior to the litigation in the *Keinath* case.

I would also say if we are going to quibble about this, that *Keinath* was docketed in 1969. A careful lawyer who is dealing with disclaimers where the consequences are like that in the *Halbach* case involving $6 million in potential gift tax liability, would have examined the docket of the Tax Court to see if there were any cases that the Internal Revenue Service was litigating. Since *Keinath* was docketed in 1969 and the *Halbach* disclaimer took place in 1970, the taxpayer, if the homework had been done, would have known that the IRS took this position. So I do not think it is quite fair to say that nobody knew about this. You had to dig to find it.

The IRS never published a revenue ruling that said they were going to take this position. That much is clear.

Mr. Duncan. Would you say that those who attempted to disclaim prior to the Supreme Court decision in the *Jewett* case were not acting in accordance with the common understanding of the legal requirements for a valid disclaimer——

Mr. Gutman. Yes. To the extent that they are asserting before this subcommittee that everybody understood that a disclaimer that was valid under State law was going to be valid for Federal tax purposes—that just was not what the law was. The *Fuller* case said it flat out. *Fuller,* decided in 1961, explicitly rejected that notion. You did not have to go to the *Fuller* case. You could look at regulations under the 1939 code that were in existence prior to the 1954 code and they would tell you the same thing with respect to renunciations of powers of appointment.

Mr. Duncan. The *Fuller* case was 1961?

Mr. Gutman. Yes.

Mr. Duncan. Then the IRS only took a contrary position—the only published rule they made was what, 1966?

Mr. Gutman. No. They began to litigate the issue when they docketed the *Keinath* case in 1969. I believe you are referring to a private letter ruling that was issued in 1966 in which the Internal Revenue Service took a position that was inconsistent with the position that they took as a litigating position. I believe—I am not 100 percent sure—that there might have been other rulings that the Service issued in that time period that were consistent with their litigating position. In any event, Mr. Duncan, it seems to me that it is quite difficult to say that a private ruling letter issued by some person in Technical ought to bind the Internal Revenue Service. Indeed, in section 6110 of the code, Congress has provided that private letter rulings have no precedential effect at all.

Mr. Duncan. You mean should not be considered at all?

Mr. Gutman. The statute provides that these private letter rulings do not have precedential value.

Mr. Duncan. But they have some value.

Mr. Gutman. They have a lot of value to the individual that got them, that is true, but they have no precedential value with respect to——

Mr. Duncan. Do you agree with the Service's interpretation that they should not have any value?

Mr. Gutman. Absolutely. I agree they should not have precedential value. You might ask Mr. Worthy about that, because he was once Chief Counsel of the IRS. If you ask whether he thought that he ought to be bound as a litigator by a letter ruling that went out of Technical while he was Chief Counsel, he might have a different view.

Mr. Duncan. Thank you.

Chairman Rangel. Thank you. I wonder whether you would and Mr. Woodward would have time to stay to answer some questions that may be raised by the new lawyers for these people.

Mr. Gutman. I would be pleased to do that, Mr. Chairman.

Chairman Rangel. Thank you.

Mr. Martin Worthy, counsel for the estate of Helen Halbach. Thank you. It is very unusual for this committee to take individual cases on the merits, but having always wanted to be a judge, you may proceed.

## STATEMENT OF K. MARTIN WORTHY, HAMEL & PARK, COUNSEL, ESTATE OF HELEN W. HALBACH

Mr. WORTHY. Thank you, Mr. Chairman. I appreciate the opportunity of being here. My name is K. Martin Worthy. I am a lawyer in the firm of Hamel & Park in Washington and have practiced tax law for more than 30 years. I was chief counsel for the IRS for 3 years, and have been chairman of the Tax Section of the American Bar Association.

I am here today to testify in support of H.R. 2813, which would amend section 2518 of the Internal Revenue Code of 1954 relating to disclaimers. The amendment, as explained by the prior witnesses, relates to disclaimers of interests created before 1958, which are now governed only by case law and regulation.

I represent the estate of Mrs. Helen Wodell Halbach. Mrs. Halbach's father died in 1937, and by his will established a trust with the income to be paid to Mrs. Halbach's mother for life with a limited power in the trustee to invade principal for the mother's benefit. The remainder if any was ultimately to be divided equally between Mrs. Halbach and her sister in the event of their survival of their mother. Thus, Mrs. Halbach's interest was wholly contingent and would not vest or become possessory in any sense until after her mother's death.

Mrs. Halbach's mother died on April 14, 1970, and Mrs. Halbach, 4 days later, executed a document in which she irrevocably renounced and disclaimed all her right, title, and interest in the one-half share of the trust to which she would otherwise have been entitled. The bank administering the trust thereupon brought an action in the New Jersey courts to determine the effect of the disclaimer, and the chancery court of New Jersey, in a carefully developed opinion published at 274 Atlantic 2d 614, held in late 1970 that the disclaimer, having been executed promptly after the death of the life tenant, was effective to prevent any passage of title to Mrs. Halbach. The court thus required distribution of the half interest in the trust to which Mrs. Halbach would otherwise have been entitled just as if Mrs. Halbach had not survived. The court significantly noted not only that this was the accepted law of New Jersey, but also that the court had been unable to turn up any court decision anywhere, Federal or State, that to be effective (as the IRS now contends), a remainderman's renunciation must occur within a reasonable time after learning that a remainder interest has been created—but that it is sufficient under the law everywhere so far as the court could find, within a reasonable time after termination of any preceding life interest.

Mrs. Halbach had no reason to believe, when she executed her disclaimer in 1970, that she had in any way made a transfer of property subject to gift tax. However, by reason of the Supreme Court's 1982 decision in *Jewett* v. *Commissioner* and the earlier failure of Congress in enacting section 2518 to deal with disclaimers of interests created before 1976, except to say that existing law applied, citing the *Keinath* case with apparent approval, Mrs. Halbach's estate is being threatened with a gift tax on the value of the interest in the trust which she disclaimed in 1970 just as if she had accepted it and then later voluntarily transferred it to persons of her own choosing.

Incidentally, Mr. Chairman, Mr. Gutman said that the Tax Court had decided this issue against Mrs. Halbach in 1978. The issue before the Tax Court in 1978 was whether she had made a gift in contemplation of death for estate tax purposes. Although the court found that a transfer occurred, it concluded that there was no gift in contemplation of death, so that the issue was ultimately decided for the taxpayer, not for the Government as suggested by Mr. Gutman.

It has been accepted for nearly 50 years that a disclaimer or renunciation refusing to accept a gift or transfer by will, is not itself a transfer subject to gift or estate tax if the disclaimer is valid and properly made. Although until 1976 the code contained no provisions governing the gift tax effect of disclaimers, in 1958 the Treasury published a regulation recognizing this court-established principle.

Before the 1958 regulation the courts of appeals had made it clear that a disclaimer which was valid and effective under State law did not result in a taxable gift. Although there was some variance in State disclaimer statutes and some States had no disclaimer statutes at all, it was clear from the authorities (such as "Page on Wills") that as a general rule a disclaimer of an interest was valid under State law if it was unequivocal, made without prior acceptance, and made within a reasonable time. Furthermore—just as later held by the New Jersey court in connection with Mrs. Halbach's disclaimer—in the case of an interest which did not take effect in immediate possession, a disclaimer did not have to be made before the termination of the preceding interest to meet the "reasonable time" requirement.

Two years ago, in the *Jewett* case, however, the Supreme Court interpreted the 1958 regulation to mean that a disclaimer after 1958 of an interest created before section 2518 of the code was enacted in 1976, will be recognized as free from gift tax only if the disclaimer is made shortly after the disclaimant obtains knowledge of the creation of such interest rather than after knowledge of its vesting, as the courts had previously held. Under this interpretation future interests must have been disclaimed soon after their creation, no matter how unlikely or contingent the possibility that anything would ever be received. Because the 1958 regulation, as so interpreted, is clearly contrary to accepted case law before 1958 (and contrary to what many justifiably continued to believe was the law even after the regulation was promulgated in 1958 until well after Mrs. Halbach executed her disclaimer in 1970), the Supreme Court's decision is very unfair to Mrs. Halbach and other holders of pre-1958 contingent interests. Under existing case law before the *Jewett* decision in 1982, they had no reason to disclaim a pre-1958 contingent interest until immediately after they obtained knowledge that the interest had vested, even if they had knowledge of the existence of the interest from its creation.

As Mr. Gutman has acknowledged in response to a question, the *Fuller* case in the Tax Court in the 1960's did not establish the rule that *Jewett* established. *Fuller* involved a disclaimer of a vested life income interest, not a contingent remainder interest, and that case rests on the fact that the taxpayer had accepted the life income interest for 25 years before the disclaimer and the regulations did make clear that an acceptance of an interest prior to a disclaimer made the disclaimer ineffective. That is not only the rule of the regulations, it is the rule as far as I know everywhere.

The 1958 regulation as interpreted by the Supreme Court in *Jewett* gave holders of contingent remainder interests no opportunity to disclaim their pre-1958 interests without gift tax, since it was already too late to do so when the regulation was promulgated. Thus, according to *Jewett,* Mrs. Halbach, whose contingent remainder interest was created in 1937, should have made her disclaimer 21 years before the 1958 regulation imposing the new test was issued. Surely, the ex post facto nature of this regulation, retroactively changing the rules, without any grace period, as to when a pre-1958 contingent interest may be disclaimed without gift tax, cries out for congressional redress.

H.R. 2813 would correct the very unfair effect of the Supreme Court decision in the *Jewett* case, as would a virtually identical provision adopted by the Senate as section 803 of its amendment to H.R. 2163, provide a grace period of 90 days after the enactment of the bill for making qualified disclaimers of property made before issuance of the regulations on November 15, 1958.

Last June at a hearing of the Senate Finance Subcommittee on State and Gift Taxation, the New York State Bar Association testified in strong support of S. 1180, a bill identical to H.R. 2813, and the American Bar Association testified in favor of an even more liberal relief provision which would allow the holder of a future interest to make a qualified disclaimer within 9 months after the contingent interest had become indefeasible.

It should be emphasized that Mrs. Halbach had no reason to know at the time of her disclaimer in 1970 that the Service would claim that such disclaimer was subject to gift tax. The Supreme Court acknowledged in its opinion in *Jewett* that it was not clear whether the regulation required that to be effective the disclaimer be made upon creation of a contingent remainder interest or upon subsequent vesting on death of the life tenant. Even Mr. Gutman in his prepared testimony today has referred to the 1958 regulation as, and I quote him, "ambiguous." There was no calculated gamble, as asserted by Mr. Woodward, in 1970 when Mrs. Halbach executed her disclaimer. In fact, the position taken by the Service in the *Jewett* litigation with respect to the meaning of the 1958 regulations is specifically inconsistent with the Internal Revenue Service's own interpretation of such regulation in the only ruling thereunder we have been able to find, which is private letter ruling 6612201590A, which was issued by the Service prior to Mrs. Halbach's disclaimer in 1970.

Let me comment, Mr. Duncan, in response to your question to Mr. Gutman, that while it is true that section 6110(j)(3) of the Code provides that private rulings ordinarily may not be used or cited as precedent, the Supreme Court, in refusing to accept the Government's interpretation of a longstanding regulation, in *Rowan Cos.* v. *United States* reported at 101 Supreme Court 2288, has said that despite that Code provision private rulings may be used, and the Supreme Court did in fact cite a private ruling, as evidence that the Internal Revenue Service had taken a position inconsistent with its contentions as to the meanings of the law and regulations. Thus the 1966 ruling is cited here in exactly the same circumstance as another private ruling was cited by the Supreme Court in the *Rowan* case.

We have been unable to find why the 1966 ruling was not called to the Supreme Court's attention in *Jewett* and the Court in reaching its conclusion mistakenly found that "the Commission's interpretation of the regulation," which it thought was "entitled to respect," had been "consistent over the years," which in light of the 1966 ruling is simply not so. In truth, as acknowledged by the counsel for the Commissioner of Internal Revenue in oral argument before the Supreme Court in *Jewett* on December 1, 1981, and not just asserted by us, but as acknowledged by counsel for the Government, it was not until litigation in the Tax Court in 1972, 2 years after Mrs. Halbach's disclaimer, that the Service first publicly stated that it interpreted the regulation as it now does as requiring the holder of a future contingent interest to disclaim shortly after knowledge of its creation rather than after knowledge of determination of the preceding interest. There was no gamble apparent. All the law at the time said was that an effective disclaimer could be made immediately after a remainder interest vests and need not have been made earlier.

That the taxpayer knew or should have known as the Government claims that the regulations meant what the Service now claims it means was certainly not obvious to the U.S. Court of Appeals for the Eighth Circuit as late as 1973 when it held in *Keinath* v. *Commissioner* that the interpretation now claimed by the Internal Revenue Service and the Treasury Department was incorrect. It said, like the New Jersey court, that it could find, and I quote, "no contrary authority" and "that this is the prevailing common law rule, which also is sound in principle and reason." The Eighth Circuit reaffirmed this view in 1980 in *Cotrell* v. *Commissioner,* 628 F. 2d 1127, holding that Mrs. Halbach's sister's disclaimer of an identical interest in the same trust as Mrs. Halbach's 11 days after Mrs. Halbach's disclaimer was not subject to gift tax.

If Mrs. Halbach's father had simply left the trust property outright to her mother or even left it in trust but given the mother power of appointment to designate the remainderman by her will, and the mother had designated Mrs. Halbach as recipient of half the property, if she survived, otherwise to Mrs. Halbach's children, and Mrs. Halbach had disclaimed that interest 4 days after the mother died, knowing full well where it would go, just as in fact she did in 1970, such interest would clearly have escaped gift tax for Mrs. Halbach. Why should the result be any different here?

It is readily conceded by the Treasury the interest would have escaped gift tax anyway if Mrs. Halbach had disclaimed in 1937.

The Government's witness and Mr. Gutman make much of the fact that H.R. 2813 would overturn a Supreme Court decision. The Treasury has not hesitated to ask the Congress to overturn a Supreme Court decision when it thought it was wrong. Note, for example, code section 2036, enacted at the urging of the Treasury in

1976, overturning the Supreme Court's estate tax decision in *Byrum* in 1972.

The Government's witness also makes much of the fact that H.R. 2813 would be retroactive in the sense that it would overturn *Jewett* as to disclaimers made prior to that decision. It is ironic that they put so much emphasis on retroactivity and do not express the same concern as to retroactivity in connection with the Government's interpretation of the 1958 regulation first announced in 1972, saying that to be effective Mrs. Halbach's disclaimer should not have been made in 1970 but should have been made immediately after her father's death in 1937.

In conclusion I submit, Mr. Chairman, that it is only fair and equitable for this Congress to provide relief to taxpayers who in good faith relied on existing case law and never had an opportunity to make a timely disclaimer of their pre-1958 contingent interests under the 1958 regulation as interpreted by the Supreme Court in 1982. Congressional relief from the imposition of the tax on the disclaimer of the pre-1958 interest is particularly appealing in Mrs. Halbach's case, since she made the identical disclaimer 11 days earlier than her sister, whose disclaimer was found free of such tax by the Eighth Circuit.

Thank you, Mr. Chairman.

[The prepared statement follows:]

### STATEMENT OF K. MARTIN WORTHY, COUNSEL, ESTATE OF HELEN W. HALBACH

#### SUMMARY

Before the U.S. Supreme Court's 1982 interpretation of a 1958 Treasury Regulation, U.S. Courts of Appeals had made clear that a disclaimer valid under state law did not result in a taxable gift, and that as a general rule of state law, in the case of a contingent future interest, a disclaimer made within a "reasonable time" after termination of the preceding interest was considered an effective disclaimer of the future interest.

In *Jewett*, decided in 1982, the U.S. Supreme Court, interpreting the requirement of the 1958 Regulation that a disclaimer be made "within a reasonable time after knowledge of the existence of the transfer," adopted a contention of the IRS that a disclaimer of a pre-1958 contingent future interest is free from gift tax only if made shortly after the initial transfer which created the contingent interest.

Because the Regulation finally adopted in 1958 differed significantly from an earlier proposed version, it appeared that the Regulation made no change in the pre-1958 law with respect to the time for disclaimers of contingent future interests. Moreover, despite the assertion of the Supreme Court in *Jewett* that the IRS always consistently interpreted the 1958 Regulation to require disclaimer shortly after the creation of a contingent interest, in fact the IRS did not publicly take that position until 1972 (2 years after our client's disclaimer) and actually took a contrary position in the only prior published or private ruling found on the subject (issued in 1966).

The IRS, by promulgating the 1958 Regulation, as interpreted by the Supreme Court, suddenly changed the rules in the middle of the game for a taxpayer owning a contingent interest created before 1958 without any opportunity to make a tax-free disclaimer thereafter.

H.R. 2813, which is the subject of the May 7, 1984 hearing of this Subcommittee, was introduced on April 28, 1983 to correct the unfair effect of the *Jewett* case by providing a grace period of 90 days after enactment of the bill for making disclaimers of interests created by a transfer of property made before November 15, 1958. The bill makes explicit the interest or any of its benefits.

#### STATEMENT

My name is K. Martin Worthy. I am a lawyer in the firm of Hamel & Park in Washington, D.C. and have practiced tax law for more than 30 years.

I am here today to testify in support of H.R. 2813, which would amend section 2518 of the Internal Revenue Code of 1954 relating to disclaimers. The amendment relates to disclaimers of interests created before 1958, which are now governed only by case law and regulation.

I represent the Estate of Mrs. Helen Wodell Halbach, who died while a resident of New Jersey in 1972. Mrs. Halbach's father died in 1937, and by his will established a trust with the income to be paid to Mrs. Halbach's mother for life, with the remainder to be divided equally between Mrs. Halbach and her sister in the event of their survival of their mother. Thus, Mrs. Halbach's interest was wholly contingent and would not vest or become possessory in any sense until after her mother's death.

Mrs. Halbach's mother died on April 14, 1970, and Mrs. Halbach, four days later, executed a document in which she irrevocably renounced and disclaimed all her right, title and interest in the one-half share of the trust to which she would otherwise have been entitled. The bank administering the trust thereupon brought an action in the New Jersey courts to determine the effect of the disclaimer, and the Chancery court of New Jersey, in a carefully developed opinion published at 274 Atlantic 2d 614, held in later 1970 that the disclaimer, having been executed promptly after the death of the life tenant, was effective to prevent any passage of title to Mrs. Halbach. The Court thus required distribution of the half interest in the trust to which Mrs. Halbach would otherwise have been entitled just as if Mrs. Halbach had not survived. The Court significantly noted not only that this was the accepted law of New Jersey, but also that the Court has been unable to turn up any court decision anywhere (as the Internal Revenue Service later contended) that to be effective a remainderman's renunciation must occur within a reasonable time after learning that a remainder interest has been created—but that it is sufficient if renunciation occurs within a reasonable time after termination of any preceding life interest.

As we will demonstrate in a moment, Mrs. Halbach had no reason to believe, when she executed her disclaimer in 1970, that she had in any way made a transfer of property subject to gift tax. However, by reason of the Supreme Court's 1982 decision in *Jewett* v. *Commissioner* and the failure of Congress in enacting section 2518 to deal specifically with disclaimers of interest created before 1976, Mrs. Halbach's estate is being threatened with a gift tax on the value of the interest in the trust which she disclaimed in 1970 just as if she had accepted it and then later voluntarily transferred it to persons of her own choosing.

It has been accepted for nearly fifty years that a disclaimer or renunciation refusing to accept a gift or transfer by will is not itself a transfer subject to gift or estate tax if the disclaimer is valid and properly made. Although until 1976 the Code contained no provisions governing the gift tax effect of disclaimers, in 1958 the Treasury published a Regulation recognizing this court/established principle.

Before the 1958 Regulation the courts of appeals had made it clear that a disclaimer which was valid and effective under state law did not result in a taxable gift. Although there was some variance in state disclaimer statutes and some states had no disclaimer statutes at all, it was clear from the authorities (such as *Page on Wills*) that as a general rule a disclaimer of an interest was valid under state law if it was unequivocal, made without prior acceptance, and made within a reasonable time. Furthermore—just as later held by the New Jersey court in connection with Mrs. Halbach's disclaimer—in the case of an interest which did not take effect in immediate possession, a disclaimer did not have to be made before the termination of the preceding interest to meet the "reasonable time" requirement.

In the *Jewett* case, however, the Supreme Court held that under the 1958 Regulation a disclaimer after 1958 of an interest created before section 2518 of the Code was enacted in 1976, will be recognized as free from gift tax only if the disclaimer is made shortly after the disclaimant obtains knowledge of the creation of such interest rather than after knowledge of its vesting, as the courts had previously held. Under this interpretation future interests must have been disclaimed soon after their creation, no matter how unlikely or contingent the possibility that anything would ever be received. Because the 1958 Regulation, as so interpreted, is clearly contrary to accepted case law before 1958 (and contrary to what many justifiably understood the law still to be even after the Regulation was promulgated in 1958 until well after Mrs. Halbach executed her disclaimer in 1970), the Supreme Court's decision is very unfair to Mrs. Halbach and other holders of pre-1958 contingent interests. Under existing case law before the *Jewett* decision in 1982, they had no reason to disclaim a pre-1958 contingent interest until after they obtained knowledge that the interest had vested, even if they had knowledge of the existence of the interest from its creation. Yet the 1958 Regulation as interpreted by the Supreme

Court in *Jewett* gave such holders no opportunity to disclaim their pre-1958 interests without gift tax, since it was already too late to do so when the Regulation was promulgated. Thus, according to *Jewett,* Mrs. Halbach, whose contingent remainder interest was created in 1937, should have made her disclaimer 21 years before the 1958 Regulation imposing the new test was issued. Surely, the ex post facto nature of this Regulation, retroactively changing the rules, without any grace period, as to when a pre-1958 contingent interest may be disclaimed without gift tax, cries out for Congressional redress.

H.R. 2813 would correct the very unfair effect of the Supreme Court decision in the *Jewett* case by amending Section 2518 of the Internal Revenue Code of 1954, relating to disclaimers. H.R. 2813 would (as would a substantially similar provision adopted by the Senate as section 803 in its amendment to H.R. 2163 on April 13, 1984) provide a grace period of 90 days after the enactment of the bill for making qualified disclaimers of property interests created by transfers of property made before issuance of the Regulation on November 15, 1958. This bill limits the availability of this statutory relief by expressly providing as a condition to qualification that "such person disclaiming has not accepted the interest or any of its benefits."

Last June I filed a written statement on behalf of the Halbach Estate in support of S. 1180, a companion bill to H.R. 2813, at a hearing of the Senate Finance Subcommittee on Estate and Gift Taxation. The New York State Bar Association testified at that hearing in support of S. 1180, and the American Bar Association testified in favor of an even more liberal relief provision which would allow the holder of a future interest to make a qualified disclaimer within 9 months after the contingent interest had become indefeasible.

The basis for relief from the unfair effect of the 1958 Regulation, as interpreted in the *Jewett* decision, on those who held contingent interests when the Regulation was promulgated in 1958 should not depend in any way on whether such holders knew of the existence of their interests. The important point is that they also knew that pre-1958 law did not require a disclaimer to be made until their interests became vested. Thus, the real issue is whether Congress should provide relief from what the *Jewett* case has interpreted as a new requirement in the 1958 Regulation, for the limited group for whom it was already too late to meet such requirement when it was imposed.

It should be emphasized that Mrs. Halbach had no reason to know at the time of her disclaimer in 1970 that the Service would claim that such disclaimer was subject to gift tax. The Supreme Court acknowledged in its opinion in *Jewett* that it was not entirely clear whether the Regulation required that to be effective the disclaimer be made upon creation of a contingent remainder interest or upon subsequent vesting on death of the life tenant.

(1) In fact, the position taken by the Service in the *Jewett* litigation with respect to the meaning of the 1958 Regulation is specifically inconsistent with the Service's interpretation of such Regulation in the only ruling thereunder we have been able to find (Private Letter Ruling 6612201590A), which was issued by the Service prior to Mrs. Halbach's disclaimer in 1970. We have been unable to find why this ruling was not called to the Supreme Court's attention in *Jewett,* and the Court, in making its conclusion, mistakenly found that "the Commissioner's interpretation of the regulation has been consistent over the years" and concluded that it was therefore "entitled to respect."

(2) In truth, as acknowledged by counsel for the Commissioner of Internal Revenue in oral argument before the Supreme Court in *Jewett* on December 1, 1981, it was not until litigation in the Tax Court in 1972 that the Service first publicly stated that it interpreted the Regulation as it now does, as requiring the holder of a future contingent interest to disclaim shortly after knowledge of its creation rather than after knowledge of the termination of the preceding interest.

(3) That the taxpayer knew or should have known that the Regulation meant what the Service now claims it means was certainly not obvious to the United States Court of Appeals for the Eighth Circuit as late as 1973, when it held that the interpretation now claimed by the Internal Revenue Service and the Treasury Department was incorrect. *Keinath* v. *Commissioner,* 480 F.2d 57. The Eighth Circuit reaffirmed this view in 1980 in *Cotrell* v. *Commissioner,* 628 F.2d 1127, holding that Mrs. Halbach's sister's disclaimer of her identical interest in the same trust at the same time was not subject to gift tax.

In conclusion, it is our contention that it is only fair and equitable for this Congress to provide relief to taxpayers who in good faith relied on existing case law and never had an opportunity to make a timely disclaimer of their pre-1958 contingent interests under the prerequisites of the 1958 Regulation, as interpreted by the Supreme Court in 1982.

Congressional relief from the imposition of the Federal gift tax on the disclaimer of the pre-1958 interest is particularly appealing in the instant case under a "basic fairness" test, since my client made the identical disclaimer at the same time as her sister who has been relieved from such gift tax by the Eighth Circuit.

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## TECHNICAL ANALYSIS AND BACKGROUND OF H.R. 2813 AND S. 1180—PROPOSED AMENDMENT TO SECTION 2518

### I. BACKGROUND

It has long been established that a disclaimer or renunciation—i.e., a refusal to accept a gift or transfer by will—is not itself a transfer subject to gift tax if the disclaimer is timely and properly made. Although until 1976 the Internal Revenue Code of 1954 ("the Code") contained no provisions governing the gift tax effect of disclaimers, in 1958 the Treasury published a regulation recognizing this court-established principle.

However, even under the regulation, the effectiveness of a disclaimer for federal tax purposes varied according to applicable state law. By the 1970's it had become apparent to members of the tax bar and others that a uniform definition of disclaimers would be desirable for federal tax purposes. See H. Rept. No. 94-1380, 66, 1976-3 C.B. (Vol. 3) 735, 800. The Section of Taxation of the American Bar Association accordingly recommended that the Internal Revenue Code be amended "to provide comprehensive uniform rules for the exemption from estate and gift taxes of property that is disclaimed in a specific manner within a specified time." Tax Section Recommendation No. 1974-2, 27 Tax Law. 818 (1974).

In response to the movement for a uniform disclaimer rule, Congress enacted new section 2518 of the Code in the Tax Reform Act of 1976. That section generally requires that a "qualified disclaimer" for Federal estate and gift tax purposes, i.e., a disclaimer that does not constitute a taxable gift, be made (a) in writing, (b) before acceptance of the interest being disclaimed or any of its benefits, and (c) within 9 months after the later of the date on which the transfer creating the interest is made or the day on which the disclaimant attains age 21. Section 2518 was subsequently amended in 1978 and 1981 to perfect and clarify the uniform rule.

Under present law section 2518 applies only to disclaimers of interests created after December 31, 1976. Thus, in the absence of amendment of section 2518, the broad class of disclaimants of interests in trusts created before 1958 remain subject to the law in effect before section 2518 was enacted, irrespective of when the interests become possessory and when the disclaimers are made—even 40 or 50 or more years from now.

### II. DESCRIPTION OF BILLS

H.R. 2813 and S. 1180 are identical companion bills which were introduced in their respective houses on April 28, 1983. The House bill is sponsored by Mr. Conable, along with Mr. Guarini and Mr. Lundine. S. 1180 is sponsored by Mr. Symms, along with Mr. Boren and Mr. Wallop, and was considered at a hearing of the Subcommittee on Estate and Gift Taxation of the Senate Finance Committee on June 27, 1983. A substantially similar provision was reported out by the Finance Committee as part of the 1984 Deficit Reduction package and adopted by the Senate as section 803 in its amendment to H.R. 2163 on April 13, 1984. Similar but slightly less restrictive bills had been introduced in the 97th Congress (H.R. 2583 and S. 1983) in 1981 and the 96th Congress (H.R. 7601) in 1980.

H.R. 2813 and S. 1180 would add a new paragraph (4) to subsection 2518(c) of the Code, as follows:

"(4) PRIOR TRANSFERS.—A disclaimer of an interest created by a transfer of property made before November 15, 1958, shall constitute a 'qualified disclaimer' for purposes of this subtitle if—

"(A) such disclaimer satisfies the requirements of subsection (b) without regard to paragraph (2) thereof,

"(B) such disclaimer was received by the transferor of the interest, his legal representative, or the holder of the legal title to the property to which the interest relates not later than 90 days following enactment of this paragraph, and

"(C) such person disclaiming has not accepted the interest or any of its benefits."

The proposed amendment would make disclaimers of interests created before November 15, 1958 (when the disclaimer regulation was first promulgated) subject to the requirements of section 2518 described above, but would provide a special transitional rule governing the period in which a qualified discalimer of such an interest could be made. That period would end 90 days following the enactment of the bill.

### III. REASONS FOR PROPOSED AMENDMENT

In *Jewett* v. *Commissioner,* 102 S. Ct. 1082 (1982), the Supreme Court of the United States, interpreting section 25.2511-1(c), Gift Tax Regs., held that a disclaimer after 1958 of an interest created before 1977 will be recognized as free from federal gift tax only if it is made shortly after the initial transfer from which the interest sought to be disclaimed eventually emerged. Under this interpretation, future interests must have been disclaimed soon after their creation, no matter how unlikely or contingent the possibility that anything would ever be received. Such an approach is contrary to the view, widely held before the Supreme Court decided *Jewett,* that the 1958 regulation permits a tax-free disclaimer within a reaonable time after the death of the preceding life tenant, i.e. after the disclaimed interest becomes present and possessory. Moreover, as interpreted by the Supreme Court, the regulation represents a sharp departure from the law in effect prior to 1958 under which the effect of such a disclaimer was generally governed solely by State law. Thus, the Supreme Court's decision is very unfair to holders of interests created before 1958, who had no reason to disclaim before that time and never had an opportunity to disclaim without gift tax—even "within a reasonable time"—after the regulation was promulgated.

*Law before 1958*

Prior to the 1958 regulation there were few cases involving the federal estate and gift tax effect of disclaimers. Nevertheless those few cases made clear that disclaimers which were valid and effective under state law did not result in a taxable gift.

In 1933, the Sixth Circuit decided *Brown* v. *Routzahn,* 63 F.2d 914, cert. den. 290 U.S. 641 (1933). In *Brown* decedent's wife died in 1912 and left decedent one-third of all her property. On April 1920, before any distribution was made, decedent filed with the proper probate court a renunciation of his right to the third of the estate, and the court, ordering distribution to the remaining heirs, recognized the renunciation. However, at decedent's death the Commissioner contended that the value of the renounced property should be included in decedent's estate for federal estate tax purposes as a transfer made in contemplation of death.

In analyzing the issue, the court of Appeals began from the "obvious" premise that unless the decedent accepted the gift of one-third of his wife's estate or became owner of such interest before April 1920, there could be no transfer of such interest in contemplation of death within the meaning of the tax statute. Looking to state law and finding that under Ohio law a rejection of a gift by will made any time before distribution would be valid and that decedent therefore had never become owner of the property involved, the court concluded that his renunciation of the property could not be a taxable transfer for federal tax purposes.[1]

There was no indication by the Internal Revenue Service of its intent not to follow the *Brown* decision. No other decision bearing significantly upon the issue arose until 1952, when the Eight Circuit decided *Hardenbergh* v. *Commissioner,* 198 F. 2d 63, cert. den. 344 U.S. 836 (1952). In *Hardenbergh* the taxpayers attempted to renounce their interest in the estate of a decedent who had died intestate, and the Internal Revenue Service claimed that the disclaimer constituted a taxable gift. The Eighth Circuit found that immediately upon the death of the decedent title to the disclaimants' interests had vested in them by operation of Minnesota law which neither disclaimant had the power to prevent, with the result that their subsequent disclaimers constituted transfers of such interests for federal gift tax purpose. Thus *Hardenbergh* reinforced the principle that valdity of a disclaimer under state law controlled for federal estate and gift tax purposes. Indeed, *Hardenbergh* cited *Brown* with approval with respect to disclaimers of testamentary gifts, carefully distinghishing *Brown* on the basis of the testate-intestate law difference. 198 F. 2d at 66.

A number of commentators during this period recognized the principle that state law controlled in determining the tax effect of disclaimers. See, e.g., Ekman, "Can A Transferee Avoid Gift or Estate Tax Liability by Renouncing A 'Transfer By Operation of Law'" 11 N.Y.U. Inst. on Fed. Tax'n 527, 532-534 (1953); Sayles, "Renunciations—Estate and Gift Tax Problems," 1853 S. Cal Tax Inst. 531, 536-539. There was some variance in state disclaimer statutes, and some states, in fact, has no disclaimer statute at all. Nevertheless, as a general rule a disclaimer of an interest was valid under state law if it was unequivocal, made without previous acceptance, and made within a reasonable time. 6 Bowe-Parker, Page on Wills § 49.9, 49.1, 49.8 (1962); 96 C.J.S. § 1151(b), 1151(a) (1957). In the case of an interest which did not take effect in immediate possession, a disclaimer did not have to be made before the termination of the preceding interest to meet the "reasonable time" requirement. See 6 Bowe-Parker, Page on Wills § 49.8 (1962). Also see *Estate of Page,* 74 A.2d 614, 615-616 (N.J. Super. 1970).

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[1] Although *Brown* involved the meaning of "transfer" for estate tax purposes, as we shall see, the term has been interpreted in the same manner under the gift tax. As the Supreme Court has stated, the federal estate and gift taxes are in pari materia and must be construed together. *Estate of Sanford* v. *Commissioner,* 308 U.S. 39, 44 (1939). Also see S. Rept. No. 1013, Part 2, 80th Cong., 2d Sess., 32, 1948-1 C.B. 285, 353.

A review of these cases and commentary reveals that prior to 1958 nothing in federal estate or gift tax law would require the holder of a remainder interest created by will to disclaim immediately upon the creation of the interest. Generally under state law the holder could wait until a reasonable time after the termination of the preceding interest, and the decided cases indicated that federal tax consequences of the disclaimer were controlled by state law. Against this historical background, section 25.2511-1(c), Gift Tax Regs., was issued in final form on November 15, 1958.

*The 1958 regulation*

Section 25-2511-1(c), Gift Tax Regs., which has not been changed since it was promulgated in final form in 1958, provides in pertinent part as follows:

*"Where the law governing the administration of the decedent's estate gives a beneficiary, heir, or next-of-kin a right to completely and unqualifiedly refuse to accept ownership of property transferred from a decedent* (whether the transfer is effected by the decedent's will or by the law of descent and distribution of interest property), *a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocable [sic] and effective under the local law. There can be no refusal of ownership of property after its acceptance.* Where the local law does not permit such a refusal, any disposition by the beneficiary, heir or next-of-kin whereby ownership is transferred gratuitously to another constitutes the making of a gift by the beneficiary, heir or next-of-kin. In any case where a refusal is purported to relate to only a part of the property, the determination of whether or not there has been a complete and unqualified refusal to accept ownership will depend on all of the facts and circumstances in each particular case, taking into account the recognition and effectiveness of such a purported refusal under the local law. In the absence of facts to the contrary, if a person fails to refuse to accept a transfer to him of ownership of a decedent's property within a reasonable time after learning of the existence of the transfer, he will be presumed to have accepted the property. In illustration, if Blackacre was devised to A under the decedent's will (which also provided that all lapsed legacies and devises shall go to B, the residuary beneficiary), and under the local law A could refuse to accept ownership in which case title would be considered as never having passed to A, A's refusal to accept Blackacre within a reasonable time of learning of the devise will hot constitute the making of a gift by A. to B. However, if a decedent who owned Greenacre died intestate with C and D as his only heirs, and under local law the heir of an intestate cannot by refusal to accept, prevent himself from becoming an owner of intestate property, any gratuitous disposition by C (by whatever term it is known) whereby he gives up his ownership of a portion of Greenacre and D acquires the whole thereof constitutes the making of a gift by C to D." Emphasis added.

This version of the regulation is somewhat different from a draft initially proposed on January 3, 1957, which required a renunciation to be made "within a reasonable time after knowledge of the existence of the *interest*" (emphasis added), rather than after knowledge of the existence of the *"transfer,"* as provided in the final regulation. The word "interest" would clearly include a contingent remainder even though the creation of that remainder by will did not effect a "transfer" to the disclaimant. Thus, under the regulation as originally proposed, the holder of a future interest would only have had a reasonable time after the creation of the interest in which to disclaim and would not have been permitted to wait until the interest became present and possessory by transfer of the property to him.

On its face, this difference between the proposed and final regulations suggests that the final regulation was a rejection of the requirement of the proposed regulation that a disclaimer of a contingent interest be made within a reasonable time after its creation rather than a reasonable time after it became possessory. However, in its *Jewett* opinion the Supreme Court considered the change in language and concluded, based on a Memorandum from the Commissioner of Internal Revenue to the Secretary of the Treasury, dated October 1, 1958, that the reason for the change was unrelated to the issue of when a future interest must be disclaimed. With respect to the disclaimer regulation, the Memorandum provides in part as follows:

"In what was intended to be the application of the rules in *Brown* v. *Routzahn* (1933) 63 F.2d 914, cert. denied 290 U.S. 641, and *Hardenbergh* v. *Commissioner* (1952) 198 F.2d 63, cert. denied 344 U.S. 836, it was stated that where title to the property did not vest in the beneficiary of heir immediately upon the decedent's death, the renunciation of the property did not constitute the making of a gift, but that, where title vested in the beneficiary or heir immediately upon the decedent's death, the act of the beneficiary or heir in giving up what passed to him from the decedent constituted the making of a gift. . . Protests on these provisions were received. After reviewing these protests, we have reconsidered our position and now believe that the proper distinction between these two court cases turns on the question of whether under the applicable State law a beneficiary of heir can or cannot refuse to accept ownership of the property which passed from the decedent. Accordingly, we have revised paragraph (c) of section 25.2511-1 to reflect this change of position." XIII Tax Notes 203, July 27, 1981.

Two things are apparent: (1) Even if it is assumed that the drafters of the final regulation were not intentionally trying to state a different rule for contingent interests than set forth in the proposed regulation, this would not have been apparent to holders of contingent interests at the time, since the Memorandum was not made public until June 15, 1981. (2) The Memorandum clearly indicates that the drafters were trying to soften the inflexibility of the proposed rules and to provide, instead, that state law would apply in every situation. And, as previously noted, under the law applicable in most states, in the case of an interest which did not take effect in immediate possession, a disclaimer did not have to be made before the termination of the preceding interest to meet the "reasonable time" requirement.

It was not immediately apparent that the 1958 regulation was intended to make a change in the Treasury position as to when a valid disclaimer must occur. Although it specified three requirements not mentioned in *Brown*—that a disclaimer be unequivocal, that it be made before acceptance of the interest, and that it be made within a reasonable time of knowledge of the existence of the transfer, the Eighth Circuit subsequently observed that the conditions in the regulation were "but a codification of common law principles applicable to the doctrine of disclaimers." *Keinath* v. *Commissioner,* 480 F. 2d 57, 61 (1973).

What taxpayers and the tax bar did not then know was that the IRS would eventually introduce a new concept by contending that when it said a taxpayer must disclaim within a reasonable time after "the transfer," it meant in the case of a contingent interest, a reasonable time after creation of the interest rather than a reasonable time after the interest became possessory. It was in litigation of *Keinath* v. *Commissioner* in the Tax Court in 1972, that the Service first publicly took the position that the regulation required the holder of a future interest to disclaim shortly after the interest was created rather than after the termination of the preceding interest. See statement of counsel for the Commissioner of Internal Revenue in oral argument before the U.S. Supreme Court in *Jewett* v. *Commissioner,* No. 80-1614, 44-45 (December 1, 1981). This position of the Service was inconsistent with the *Brown* case, which the Memorandum indicates was intended to be embodied in the regulation, and contrary to the general principle of state law that disclaimers could be made after termination of the preceding life interest.

It now further appears that the position the IRS took in *Keinath* was also inconsistent with its own position in an earlier private letter ruling (6612201590A) dated December 20, 1966, attached.[2] In that ruling the IRS held that a taxpayer's proposed disclaimer of a contingent interest in a trust created 33 years earlier would not be taxable as a gift. Under the terms of the trust, after the death of the taxpayer's mother and the termination of her life interest in trust income, the income of the trust was to be paid in equal shares to the mother's surviving children (including the taxpayer) and to the "issue per stripes" of any child who survived the mother but died before termination of the trust. The taxpayer and her three siblings each received a one-forth share of trust income after the death of their mother in 1936. Much later, in 1963 and 1964, the taxpayer became eligible for two additional one-eighth income interests because of the deaths of two siblings who were survived by adopted sons but not by "issue." The Service ruled that if a desclaimer was executed "within a 'reasonable time' from the time that she first received notice [by reason of court decision that the income interest had vested in her] of her right to the additional income interest," the requirements of the regulation would be satisfied and no gift tax would be due. Because the taxpayer already held another interest in the trust from which she had received income for nearly 30 years, she had obviously long been aware of the creation of the trust 33 years earlier and of her contingent interests in her siblings' shares in the event of survivorship. Thus, the above quoted language of the ruling means that she had a reasonable period from the time she received notice that her additional contingent income interest had vested or become possessory, even though that interest had been created 33 years earlier.

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[2] Although private rulings were confidential at that time, since 1976 they have been released to the public, and this particular ruling was made open to public inspection on August 28, 1978.

A careful review of the private rulings issued as far back as 1954 which have been released to the public reveals no ruling requiring disclaimer of a future interest before the preceding life tenant's death until the Service publicly took that position in *Keinath*. While the Service refused to rule in two cases involving present possessory interests on the timely disclaimer issued in 1973 on the ground that whether a disclaimer was made within a reasonable time was a factual issue to be decided by the district director (PR 7302140070A and (PR 7307190100A), there appears to be no ruling embodying the IRS position in *Keinath* until 1978 (PR 7806080).

Although all of these private letter rulings were public when the *Jewett* case was briefed and argued before the Supreme Court, the Court was apparently not made aware of the inconsistent interpretations of the regulation made by the IRS.[3] In fact, the court expressly noted tin upholding the Commissioner's interpretation of the regulation that the Service had been consistent in its interpretations over the years (102 S. Ct. 1090)—which is simply not so.

*Conclusion*

This examination of the federal gift tax law on disclaimers before and after 1958 demonstrates that under the *Brown* and *Heidenbergh* cases the validity to the disclaimer under state law determined the federal gift tax result. Thus, before 1958 the holder of a contingent remainder had no reason to disclaim prior to the death of the preceding life tenant.

After the promulgation of the 1958 regulation it was not apparent that that had been any change in the law. First of all, the deletion of language from the proposed regulation which required disclaimer "within a reasonable time after knowledge of the existence of the *interest*" suggested that a disclaimer could be delayed until indefeasible vesting. Furthermore, the October 1, 1958, Memorandum from the Commissioner to the Secretary of the Treasury shows that the drafters of the regulation were trying to follow the existing law of the *Brown* and *Heidenbergh* cases. In addition, the IRS itself, in Private Ruling 6612201590A, issued December 20, 1966, ruled that a disclaimer of a contingent future interest would satisfy the regulation if made after notice that the interest had vested and become possessory. Indeed, it was not until litigation of the *Keinath* case in the Tax Court in 1972, after disclaimers of taxpayers such as Helen Wodell Halbach, who disclaimed in 1970, that the IRS first publicly took the position that a defeasible future interest must be disclaimed shortly after its creation.

In spite of these indications of the meaning of the regulation, the Supreme Court in *Jewett* adopted the Commissioner's current contrary interpretation.[4] Thus, under the Supreme Court's interpretation, the IRS, by promulgating the 1958 regulation, changed the rules for a taxpayer owning an interest created before 1958 in the middle of the game contrary to any reasonable notion of justice or fair play.

In rejecting a similar unfairness argument by the taxpayer in *Jewett*, the Court noted that the 1958 regulation was made well in advance of the disclaimers in that case.[5] However, what is important here is that the interest was created before 1958;

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[3] Even though section 6110(j)(3) of the Code provides that private rulings ordinarily "may not be used or cited as precedent," the Supreme Court—in refusing to accept the government's interpretation of a long-standing regulation in *Rowan Companies, Inc.*, v. *U.S.*, 101 S. Ct. 2288, 2296, n. 17 (1981)—has said that private rulings maybe cited as evidence that the Internal Revenue Service has taken a position inconsistent with its present contentions as to the meaning of the law and regulations.

[4] One commentator has criticized the Court's construction of the regulation is "visibly flawed." *Jewett v. Commissioner: Unforseen Crisis of Disclaimers*, 14 Loy. L. Rev. 167, 186 (1982).

[5] The Court made the puzzling comment that the taxpayer's argument would have more appeal if the disclaimer had been made immediately after the adoption of the 1958 regulation, rather than 14 years later. 102 S.Ct. 1090, n. 20. The logic of this statement is difficult to understand if, in fact, the regulation required disclaimer in 1939 when the disclaimer interest was created. Furthermore, the taxpayer's argument takes on new meaning in light of the discovery that the IRS itself had interpreted the 1958 regulation as favorable to the taxpayer's position in 1966 before the disclaimer occurred and never publicly took the contrary view until 1972 after the disclaimer occurred.

not that it was disclaimed after 1958, since under the Court's interpretation of the regulation holders of pre-1958 interests were unfairly and unjustifiably prevented from ever disclaiming following promulgation of the regulation without incurring a gift tax. At that point, according to *Jewett*, it was already too late.[6] Congress recognized this very distinction when it made section 2518 applicable only to disclaimers of interests created after 1976; that section is currently inapplicable to disclaimers made after 1976 of interests created before 1977. See Section 2009(e) of the Tax Reform Act of 1976, P.L. 94-455, 90 Stat. 1520.[7]

H.R. 2813, S. 1180, and the disclaimer provision (section 803) of the Senate amendment to H.R. 2163 would correct the unfair effect of *Jewett* on holders of pre-1958 future interests by providing a grace period for disclaimer of such interests. As the discussion above shows, the equities weigh heavily in favor of such relief.

Chairman RANGEL. Thank you. Can you explain why Mrs. Halbach executed her disclaimer in 1970 even after the regulations were promulgated in 1958, that gap?

Mr. WORTHY. I thought, Mr. Chairman, that I had answered it. Just as she might have done had her mother left her the property by will at that time at her mother's death, she concluded immediately that she did not wish to have the property. There is nothing in the 1958 regulation to make it clear that it was the Government's position that a disclaimer needed to be made immediately after the interest was created. As I have suggested, both the New Jersey court, and the eighth circuit later, found that there was no authority anywhere that suggested a disclaimer of a contingent remainder interest need be made earlier than the date at which that contingent interest vested and immediately thereafter. She made it 4 days after it would have vested had she not made the disclaimer, which is about as prompt as could be made. It was not until 1972, as admitted by Government counsel in the Supreme Court, that the Treasury for the first time announced publicly that it interpreted the 1958 regulation as meaning that a disclaimer had to be made earlier, and even the Supreme Court found that the regulation was not clear on its face. It makes it very clear that the regulation could be read either way to mean that the disclaimer would be effective if made after the creation of the interest or after the vesting of the interest, and Mr. Gutman himself has admitted in his prepared testimony that the regulation was "ambiguous." We believe that the Supreme Court was unduly influenced by its finding that this had been the consistent position of the Service since 1958, which simply is not so in light of the 1966 private ruling directly to the contrary and in light of the fact that the Government has acknowledged that it never publicly stated the position it now espouses until 1972.

Chairman RANGEL. You stated in the testimony that the 1958 regulation as interpreted by the IRS is clearly contrary to accepted case law before 1958, is there case law as relates to future interest?

Mr. WORTHY. The only case involving the applicability of the Federal gift tax statute is the *Keinath* case. There was no case law involving the applicability of the gift tax to a contingent remainder interest. All the case law, Mr. Chairman, in the State courts and the common law, according to the court of New Jersey, and all the authorities indicated that a disclaimer was effective if made within reasonable time after the vesting of a contingent remainder, and there was case law prior to 1958 that State law was applicable. As a matter of fact the memorandum of the Treasury in support of the 1958 regulation even indicates that it intended no change, and when this Congress in 1976 enacted the present disclaimer provisions which apply only to disclaimers after 1976, it stated specifically that State law applied to prior disclaimers. I quote from the Joint Committee's explanation of the bill that says that "the disclaimer is required to be made within a 'reasonable' time after the person disclaiming learns of the existence of his interest in a property transfer. In one case, a remainderman who was aware of his interest was considered to have made a disclaimer of his remainder interest within a 'reasonable' time for gift tax purposes when he disclaimed shortly after the expiration of a life tenancy which had continued for 19 years after the grantor's death. The decision in this case might not apply in other cases involving the same facts depending upon the applicable local law."

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[6] For further criticism of the unfairness of the *Jewett* decision, see M. Wolfson, *Disclaimers—A Device Whose Time Has Come?"*, 41 N.Y.U. Inst. on Fed Tax'n 43-1, 43-23 to 43-27 (1983).

[7] One commentator argues persuasively that the legislative history of this 1976 legislation demonstrates that Congress believed that *Keinath* v. *Commissioner*, 480 F. 2d 57 (8th Cir. 1973) was the proper interpretation of the regulation and suggests that the Supreme Court in *Jewett* incorrectly ignored congressional understanding of the regulation. *Jewett* v. *Commissioner: Unforseen Crisis of Disclaimers*, 14 Loy. L. Rev. 167, 189-190 (1982).

I believe this Congress was led to believe that local law applied prior to 1976 interest when it amended the law in 1976.

Chairman RANGEL. Professor, why don't you come up to the table? Please respond to counselor's reference.

Mr. GUTMAN. Which one, the last one?

Chairman RANGEL. Yes.

Mr. GUTMAN. Sure. This language that Mr. Worthy is citing is very interesting, Mr. Rangel, because what it is is a description of what constituted present law. It says that the Federal tax consequences of the disclaimer will largely depend upon its treatment under local law. "Largely" is a different word from "exactly."

Mr. DUNCAN. It is larger than small, though, is it not?

Mr. GUTMAN. It will depend on local law to some extent, but it——

Mr. DUNCAN. Larger rather than smaller?

Mr. GUTMAN. This could be a very small point or a very large point. The thing that is more interesting about the language that Mr. Worthy referred to is that in discussing the question whether a specific time period is prescribed within which a disclaimer must be made, the committee report says that the disclaimer is required to be made within a reasonable time after the person disclaiming learns of the existence of his interest in a property transfer. That is very interesting, because these people are making the assertion that you do not have to disclaim until you get the property in possession. That is what State law was. But even if that was State law, what I am saying is that although State law might have said you could wait until you got the property in possession to make a disclaimer, that was never the Federal law, even under the 1939 code with respect to disclaimers of powers. Nor was it the Federal law in 1976, at least to the Ways and Means Committee, because the committee report states that the disclaimer has to be made within a reasonable time of the existence of an interest in property. It seems to me that that is exactly what this is about.

Mr. WORTHY. May I respond to that?

Chairman RANGEL. Of course.

Mr. WORTHY. I think the difficulty is semantical as to what the committee meant when it says the transferor, the taxpayer disclaiming, learns of the "existence of his interest in a property transfer." Mr. Gutman interprets that as meaning the existence of the original interest rather than the vesting of the interest, and I think the answer to that is in the very next sentence, which deals with the very situation involved in the *Keinath* case, and it says that the decision in that case "might not apply in other cases."

Now, if Mr. Gutman is right, it would never apply in any other case because the *Keinath* case is clearly 100 percent contrary to the position that the Treasury takes today, and that could never have applied. Therefore you must read those words, learning "of the existence of the interest," as meaning learning of the existence of the vesting of such interest in order for the next sentence in the committee report to make any sense.

Chairman RANGEL. This is why we have courts—to interpret these meanings. After you have gone to the court, I guess you come back here anyway.

Mr. DUNCAN. Mr. Chairman, I would like to ask a question. In relation to the disclaimer letter rulings, Mr. Worthy sort of refuted what you said a while ago. You said that they should not bear any weight at all.

Mr. GUTMAN. I said no precedential value. Mr. Worthy has quite correctly described what happened in a Supreme Court case where the Supreme Court looked at a private letter ruling that had been issued as representative of the Service's position.

Mr. DUNCAN. They did have some value. The Court used them.

Mr. GUTMAN. Yes. The Court used it as descriptive of the Service's position at the time.

Mr. DUNCAN. And it was of value? You said they were of no value.

Mr. GUTMAN. I said they were of no precedential value. That is, you cannot cite a private letter ruling as determinative of an issue in your case and say that because the Service has ruled this way therefore you are entitled to relief.

Mr. DUNCAN. Thank you.

Chairman RANGEL. To what extent has the Court's decision adversely affected your client from a financial standpoint?

Mr. WORTHY. The Supreme Court decision in *Jewett*?

Chairman RANGEL. Yes.

Mr. WORTHY. I think Mrs. Halbach made her disclaimer in 1970 in good faith.

Chairman RANGEL. What amount of tax liability relief would this legislation give your client?

Mr. WORTHY. I cannot tell you the precise amount.

Chairman RANGEL. No, in rough figures. You represent somebody here, and you believe the courts have acted unfairly and inequitably in terms of interpreting existing law. Obviously your client has been hurt. I am trying to find out the depth of that hurt as a result of the court action.

Mr. WORTHY. There are two beneficiaries of the estate. I believe that collectively it will involve a net tax burden of about $3.7 million, or just under $2 million each, Mr. Rangel. I think in the case of one of them it will take all their assets entirely, all they have left.

[The following was subsequently received:]

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*NOT ADMITTED IN D.C.

May 8, 1984

HAND DELIVERED

COMMITTEE ON
RECEIVED
MAY 8 1984
WAYS AND MEANS

John J. Salmon, Esquire
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: Correction of Record in Hearing on Disclaimers Before Oversight Subcommittee on May 7, 1984.

Dear Mr. Salmon:

In my testimony yesterday before the Oversight Subcommittee, Chairman Rangel asked me what the economic impact in dollars of the Jewett decision is to my client, the Estate of Helen W. Halbach. I answered that I was not certain but that I believed the impact on all estate beneficiaries to be approximately $2 million in increased tax. The Treasury challenged my figure and I have since had an opportunity to confer with the Estate's attorney to verify the amount. If Mrs. Halbach's disclaimer is treated as a taxable gift under Jewett, the net federal tax effect to her Estate after a valuation adjustment agreed to by the government and after adjustments for reduction of federal estate tax attributable to the increased debt of the Estate and for reduction of income tax on the sale of the disclaimed assets attributable to the gross up of basis for the gift tax, would be approximately $3.7 million, exclusive of interest, or just under $2 million added tax for each of the two beneficiaries of the Estate. I request that the record of the hearing be revised to reflect this correction.

Sincerely yours,

HAMEL & PARK

By: K. Martin Worthy

KMW/lc
1019L
cc: Robert Woodward, Esquire

Chairman RANGEL. Your position I assume is—I guess this is not a fair question because when you were counsel for the Government your position would not have been consistent with your statements today because the Government was your client. I'm referring to when you were Chief Counsel at the Internal Revenue Service.

Mr. WORTHY. Yes, and I was not involved in any way in any of this. I was completely unaware of it at the time.

Chairman RANGEL. I have heard a great deal about your fine reputation when you were with the Government. It is a pleasure to meet you.

Mr. Duncan.

Mr. DUNCAN. I have no further questions.

The next witness is Mr. Douglas Bennett, Powell, Goldstein, Frazer & Murphy, counsel, trusts of Elizabeth Houghton.

## STATEMENT OF DOUGLAS P. BENNETT, POWELL, GOLDSTEIN, FRAZER & MURPHY, COUNSEL, TRUSTS OF ELIZABETH HOUGHTON

Mr. BENNETT. Thank you, Mr. Duncan.

Mr. DUNCAN. You may proceed, and your statement will be made part of the record.

Mr. BENNETT. Thank you, Mr. Duncan. I will to some degree summarize. I appreciate your entering the entire statement into the record.

I am a partner in the law firm of Powell, Goldstein, Frazer & Murphy in Washington. I am glad to have the chance to appear before the committee this afternoon. I am testifying in support of the measure H.R. 2813. A like provision is contained in the tax bill currently pending in the Senate.

Briefly, a disclaimer, of course, is an individual's refusal to accept a gift or an inheritance, and the concept derives from basic property law where, generally, a transfer of property is not complete until it is accepted by the recipient. No person can be forced to accept property. As with most property rights, the common law disclaimer is governed by State or local law.

The issue posed today is the taxation of disclaimed property which was put in trust prior to 1958. In 1958 the regulation was promulgated which, as has been discussed to a great extent this afternoon, would provide that a disclaimer is not valid for gift tax purposes unless it is made within a reasonable time after knowledge of the "existence of the transfer." Practitioners in the field felt that this regulation paralleled or tracked common law and was consistent with the longstanding interpretation that a disclaimer would be effective if made within a reasonable time, as determined by local law, after the property interest became possessory in the disclaimant.

In 1972, some 14 years later, the Internal Revenue Service "interpreted" the term "transfer" to mean the time when the interest was created, not when it became possessory. Counsel for the Government admitted before the Supreme Court later on in the *Jewett* case that that (1972) was the first time publicly that the Service had taken that position. Between 1958 and 1972 there was no published position taken by the IRS which contradicted the then prevailing view which I described a moment ago. Indeed, in 1966, as we have already discussed, there was a private letter ruling—clearly inconsistent with the position that was advanced by the Treasury Department earlier—permitting a taxpayer to disclaim a contingent interest some 30 years after the establishment of the trust which created those interests.

Thus, in 1972, for the first time, the Service took a public position in litigation interpreting the 1958 regulation to mean that a disclaimer would have to be executed within a reasonable time after the interest was created even though in the case of a contingent interest it might not become possessory for many years. The 1972 litigation, the *Keinath* v. *Commissioner,* in the Eighth Circuit decided in 1973, reversed the Tax Court which had held in favor of the IRS and agreed with the interpretation that, under local law for purposes of determining reasonable time, the transfer does not occur until the interest vests in the disclaimant. The IRS curiously did not seek Supreme Court review of that adverse decision.

This was the state of the law until Congress enacted code section 2518 in the Tax Reform Act of 1976. As you will recall, section 2518 imposes, prospectively, four different restrictions or parameters that a taxpayer making a disclaimer must follow. It has to be a written disclaimer of the interest; it must be executed within 9 months after the interest is created or after reaching age 21; the disclaiming person must not have accepted the interest or any of its benefits; and the interest resulting from this refusal must pass to a successor without any direction on the part of the disclaiming person.

In enacting this legislation, it would appear that Congress believed that it was modifying and clarifying prior law under which the Federal tax treatment of disclaimers depended upon State law. I will quote from the Joint Committee report:

> Under the gift tax regulations relating to transfers in general a disclaimer must comply with local law in order to be valid for gift tax purposes.
>
> Prior law does not provide either definitive rules as to what constitutes a disclaimer or rules of general application concerning the tax consequences of a disclaimer. The Federal tax consequences of a disclaimer have largely depended on its treatment under local law, i.e., its treatment as a disclaimer so that the person disclaiming is not considered to have held title to the property at any time * * *

That is a quote from the Joint Committee pamphlet regarding the Tax Reform Act of 1976.

It would seem then that the Congress was clearly indicating its understanding that prior law imposed no specific time period by which a disclaimer must be made to be valid for gift tax purposes. It also cited the *Keinath* decision, and thus it appears that Congress was recognizing it as the prevailing judicial interpretation of the law at that time. Hence, it would further appear that the Congress felt that there was no need to grandfather interests created prior to 1976.

I also find it curious why the Treasury Department did not feel that it should deal with this situation for pre-1958 interests, which could have been dealt with at that point, particularly in light of the judicial interpretation of *Keinath.* Further, it seems that Congress' different treatment of generation-skipping transfers which were dealt with in the same bill by carefully grandfathering them so that, for at least 6 years, the new law would affect only interests created or amended after its enactment. Again, apparently the Congress did not feel that it was necessary to grandfather disclaimers of interests created prior to the date of the act.

In *Jewett* v. *Commissioner,* which we have discussed at great length, the Supreme Court finally upheld the Service's interpretation of the 1958 regulation, thus effectively overruling the eighth circuit *Keinath* decision. The court, in upholding the Service's position that the transfer occurs at the time of the creation of the interest, regardless of how contingent, apparently looked at only two issues. It is my understanding that they looked at whether or not the Commissioner's interpretation of the regulation was within his authority, and secondarily, whether the regulatory interpretation was consistently applied.

Unfortunately, taxpayer's counsel erroneously advised the court that the 1958 regulation had been consistently applied. However, the facts are that from 1958 to 1972 there was no litigated controversy, strongly suggesting that the IRS agreed with the prevailing public view for 14 years, and, second, that in 1966, in the private letter ruling referred to earlier, the Service issued a ruling permitting the disclaimer of an interest created some 30 years previously.

Taxpayers who disclaimed interests in property within a reasonable time after they became possessory, in the good faith belief, and on the advice of counsel reinforced by the *Keinath* decision, that such disclaimers would be valid under the gift tax, are now facing retroactive tax liability. Moreover, this liability occurs after the taxpayer has irrevocably surrendered the property on which this tax liability is based and which might have been used to satisfy this unexpected liability.

To correct the inequity and to apply fairness to this area of the law that Congress apparently believed had been resolved when it enacted code section 2518 in 1976, H.R. 2813 provides the means to deal with this situation justly. I will take a moment to give a specific example, which raises a few curious questions.

In 1974 a woman died of cancer at age 65. She had never been married, was survived by a brother 9 years older, a sister 12 years older, and nine nieces and nephews. When she died she was the income beneficiary of two trusts created by her father, one in 1934 and one when he died in 1941. The successor beneficiaries of each trust were her issue, but she had no issue. As a result, fractional interests in each trust fell to 10 of her siblings, nieces, and nephews. When these 10 people were advised in 1974 that they had an interest in one of these trusts, they were also advised: One, that they did not have to accept the property under State law; two, that if they chose not to accept the property they would have to act promptly; ~~and~~ three, that a disclaimer made promptly after their aunt's death would not be taxable as a gift under Federal tax law. The eighth circuit had decided this issue less than a year earlier.

Of these 10 people, 8 disclaimed and 2 kept the property. Now these eight people are faced with huge tax liabilities and are told that to have disclaimed in a timely fashion they should have done so many years earlier. In 1934 the brother was 35, the sister was 38, and a niece was 6. In 1941, some nieces were 3, 9, 17, and some nephews 5 and 15. Even if we applied current law which would state that at age 21, one would have to disclaim, that would be about 8 years before the 1958 regulation for some of these younger beneficiaries. They would have had to have looked into a crystal ball to try to figure out that there would be a regulation 8 years later to interpret the law this way for the disclaimer to be effective. By 1958 they already had no way now to disclaim under the 1972 interpretation of the regulation. When would the IRS suggest they have disclaimed?

I think, in summary, we are not talking about a group of taxpayers who gambled. We are talking about a group of taxpayers who, when faced with this situation and advised by counsel that they were about to receive an interest, had the option to keep the property or to disclaim it. If they wanted to disclaim it, they believed they had to do so promptly, at the time of this disclaimer, and because of the *Keinath* decision, it would be valid for gift tax purposes.

H.R. 2813 will correct and handle this situation I think in a fair and consistent way, and in the way that I believe Congress intended or thought it was dealt with when it passed the 1976 Tax Reform Act.

I appreciate the opportunity to appear before you this afternoon. I would be glad to try to answer any questions you might have.

[The prepared statement follows:]

## STATEMENT OF DOUGLAS P. BENNETT, ESQ., COUNSEL, TRUSTS OF ELIZABETH HOUGHTON

### SUMMARY

1. The regulatory requirement, first promulgated in 1958 by the Internal Revenue Service, that a disclaimer must be made within a "reasonable time" after knowledge of the "existence of the transfer" in order to be valid for Federal gift tax purposes was generally believed to incorportate the common understanding that the time period for disclaiming a contingent interest began at the time when it became possessory.
2. In 1966, the IRS issued a private letter ruling which treated the disclaimer of a contingent interest 30 years after its creation as valid for gift tax purposes, apparently in accord with this common understanding.
3. When the IRS took the position in 1972 that the time for disclaiming a contingent interest began when the interest was created, lost in 1973 in the Eighth Circuit in *Keinath* v. *Commissioner* (480 F.2d 58) and did not then seek Supreme Court review, the prevailing view in the legal community was that this decision was final and correct.
4. The effect of the contrary Supreme Court decision in *Jewett*, 102 S.Ct. 1082 (1982), therefore, will be to retroactively tax disclaimers of contingent interests created before 1958, when the regulation being enforced therein was first promulgated, which disclaimers were made in good faith reliance on *Keinath* and on the common understanding, at a time when the assets on which this tax will be assessed have been irrevocably surrendered.
5. Enactment of H.R. 2813 is necessary to prevent such retroactive and burdensome taxation.

### STATEMENT

Mr. Chairman, distinguished Members of the Ways and Means Committee, my name is Douglas P. Bennett. I am an attorney in the law firm of Powell, Goldstein, Frazer & Murphy in Washingtion, D.C. I appreciate this opportunity to appear before your Subcommittee today.

I am testifying in support of H,R, 2813 which amends Section 2518 of the Internal Revenue Code of 1954 as it relates to disclaimers of interests in property created before 1958.

Briefly, a disclaimer is an individual's refusal to accept a gift or an inheritance. The concept derives from basic property law where, generally, a transfer of property is not complete until it is accepted by the recipient. No person can be forced to accept property. As with most property rights, the common law disclaimer is governed by state or local law.

The issue posed today is the taxation of disclaimed property. If a disclaimer is valid for gift tax purposes, the resulting transfer will not be taxable as a gift. However, if it is not valid, the disclaiming person will be treated as having made a taxable gift, hence, be subject to a gift tax. Historically, and clearly prior to 1958, the validity of the disclaimer for gift tax purposes turned solely upon its validity under local law.

In 1958, the Internal Revenue Service issued a regulation providing that a disclaimer would not be considered valid for gift tax purposes unless it was made "within a reasonable time after knowledge of the existence of the transfer". This regulation was consistent with the long-standing interpretation that a disclaimer would be effective if made within a reasonable time (as determined by local law) after the property interest became possessory in the disclaimant. In 1972, some 14 years later, the Internal Revenue Service "interpreted" the term "transfer" to mean the time when the interest was created not when it became possessory.

Between 1958 and 1972 there was no published position taken by the IRS which contradicted the then prevailing view that the reasonable time for disclaiming a contingent interest began to run when the interest became possessory. Indeed, in 1966 the IRS issued a private letter ruling, clearly inconsistent with its present position, which permitted taxpayers to disclaim contingent income interests more than 30 years after the establishment of the trust creating those interests. In 1972, for the first time, the IRS took a public position in litigation interpreting the 1958 regulation to mean that a disclaimer would have to be executed within a reasonable time after the interest was created, even though, in the case of a contingent interest, it might not become possessory, if at all, for many years. In this litigation, *Keinath* v. *Commissioner,* 480 F. 2d 58 (8th Cir. 1973), the Eighth Circuit in reversing the Tax Court and ruling against the IRS agreed with the interpretation that, under local law, for purposes of determining "reasonable time", the "transfer" does not occur until the interest vests in the disclaimant. The Internal Revenue Service did not seek Supreme Court review. This was the state of the law until Congress enacted Code Section 2518 in the Tax Reform Act of 1976.

Code Section 2518 requires, prospectively, that beneficiaries of any interest in property created after 1976, whether vested or contingent, execute a written disclaimer of that interest within nine months after the interest is created (or after reaching age 21) in order for the disclaimer to be valid. In addition, the disclaiming person must not have accepted the interest or any of its benefits, and the interest resulting from this refusal must pass to a successor without any direction on the part of the disclaiming person.

In enacting Code Section 2518, Congress believed that it was both modifying and clarifying prior law under which the Federal tax treatment of a disclaimer depended upon state law.

"Under the gift tax regulations relating to transfers in general, a disclaimer must comply with local law in order to be valid for gift tax purposes.

"Prior law does not provide either definitive rules as to what constitutes a "disclaimer" or rules of general application concerning the tax consequences of a disclaimer. The Federal tax consequences of a disclaimer has [sic] largely depended upon its treatment under local law, i.e., its treatment as a disclaimer so that the person disclaiming is not considered to have held title to the property at any time . . ." *General Explanation of the Tax Reform Act of 1976,* JCS–33–76, at page 590.

Thus, Congress clearly indicated its understanding that prior law imposed no specific time period by which a disclaimer must be made to be valid for gift tax purposes. Importantly, Congress cited the *Keinath* decision, as indicative of present law, thus apparently recognizing it as the prevailing judicial interpretation of the law. Hence, there was no need to grandfather interests created prior to 1976. This view is further underscored by Congress' different treatment of generation skipping transfers dealth with in the same bill. Pre-1976 interests, very similar in operation to disclaimers, were carefully grandfathered so that, for at least six years, the new law would affect only interests created or amended after its enactment.

In *Jewett* v. *Commissioner,* 102 S. Ct. 1082 (1982), the Supreme Court finally upheld the IRS interpretation of the 1958 regulation, thus effectively overruling the Eighth Circuit *Keinath* decision. The Court, in upholding the IRS position that the "transfer" occurs at the time of the creation of the interest, regardless of how contingent, apparently looked at only two issues: (1) was the Commissioner's interpretation of the regulation within his authority, and (2) was the regulator interpretation consistently applied. Taxpayer's counsel erroneously advised the Court that the 1958 regulation had been consistently applied. The facts are (1) that, from 1958 to 1972, there was no litigated controversy, strongly suggesting that the IRS agreed with the prevailing public view for 14 years, and (2) that in 1966, the IRS issued a letter ruling permitting the disclaimer of an interest created some 30 years previously.

Moreover, a decision of the Supreme Court is treated as interpreting a statute, or in this case a regulation, as of the time of its promulgation. Taxpayers who disclaimed interests in property within a reasonable time after they became possessory, in the good faith belief, and on the advice of counsel reinforced by the *Keinath* decision, that such disclaimers would be valid under the gift tax, are now facing retroactive tax liability. Moreoever, this liability occurs after the taxpayer has irrevocably surrendered the property on which this tax liability is based and which might have been used to satisfy this unexpected liability.

To correct the inequity that Congress apparently believed had been resolved when it enacted Code Section 2518 in 1976, H.R. 2813 provides a 90-day grace period within which a pre-1958 interest may be disclaimed and still be considered a "qualified disclaimer". This bill allows the grandfathering that the Congress accorded in 1976 to generation skipping transfers but understood to be unnecessary here.

Thank you again for this opportunity to appear before you today and I shall be pleased to answer any questions you may have.

Chairman RANGEL. Obviously because of your youth, you didn't represent any of these people at a time when they probably needed you most?

Mr. BENNETT. No, neither of us did.

Chairman RANGEL. Did they come to you to try to correct what they believed was inequitable treatment they received in the court or are you here as a friend of the committee?

Mr. BENNETT. I am here representing the estate of Elizabeth Houghton. I think you returned to the committee room as I was going through an example.

Chairman RANGEL. To what extent has her estate been adversely affected by the Supreme Court's decision in *Jewett* in terms of tax liability?

Mr. BENNETT. I could take a brief moment—it will take me a minute.

Chairman RANGEL. Financially.

Mr. BENNETT. I don't know the amount of the tax liability. I do know that one of the recipients, I don't know the exact amount of the liability—I do know that one of the recipients that did disclaim and has no way of getting the property back, of course, to use it to offset any tax liability, would face a very devastating economic result.

Chairman RANGEL. Do you know how much we are talking about?

Mr. BENNETT. I understood from the Senate committee report, concerning the bill pending in the Senate now, the revenue estimate loss was an asterisk, indicating a $5 million loss, and I also understood it indicated for revenues which might not be received, a $30 to $40 million loss. I don't have a copy of the Senate bill.

Chairman RANGEL. Staff thinks that it may be substantially larger. Also we have no way of knowing how many people would become eligible for relief under the bill's 90-day window provision. Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman.

Mr. Bennett, Mr. Gutman stated that the IRS may have issued private letter rulings adverse to taxpayers on this point. Are you aware of whether or not a thorough search has been made for other IRS rulings on this subject?

Mr. **Bennett**. We did search it using the lawyer's tool of the Lexis system and the 1966 revenue ruling to which all of us have referred was the only one we came across.

Mr. **Duncan**. You indicated in your summary that when the IRS took its position in 1972 that the time for disclaiming the contingent interest began when the interest was created. They lost, in 1973, in the eighth circuit in *Keinath* v. *Commissioner,* and they did not seek Supreme Court review. Hasn't it been the custom and practice of the Internal Revenue Service that while they must abide by the decision in a particular circuit, they need not recognize it in other circuits?

Mr. **Bennett**. I think that is generally true. My colleague, Mr. Worthy, could better address that or the gentleman from the Treasury Department. I believe that is generally true.

Mr. **Duncan**. Are you led to believe that they abided by this decision in the States that comprised the eighth circuit and did not in others?

Mr. **Woodward**. Mr. Duncan, in a case such as this, particularly where the Tax Court has ruled in favor of the Government—the tax court is a national court to which all taxpayers bring their cases if they wish to litigate before actually paying the tax—the Government is not bound outside of the circuit in which the decision is rendered in favor of the taxpayer and can continue to litigate where the appeal would be to other circuits. That is in fact what happened in this situation.

The *Jewett* case was appealable to the Ninth Circuit Court of Appeals which held in favor of the Government, creating the conflict between the eighth and the ninth circuits, which was ultimately resolved by the Supreme Court. The Supreme Court does not take tax cases generally unless there is a conflict between the circuits, which is to make sure the lower courts have an adequate opportunity to hash out the issue before using its own limited resources to determine a national rule.

Mr. **Duncan**. In other words, your decisions and rules then apply to the eighth circuit as well as all the rest of the circuits of the country?

Mr. **Woodward**. I am not sure I understand.

Mr. **Duncan**. Well, you lost in the eighth circuit.

Mr. **Woodward**. Correct.

Mr. **Duncan**. I know in the past that when you have lost in some Federal jursidiction, you recognize that decision in that jurisdiction if you do not appeal it, but you do not necessarily recognize it in other jurisdictions.

Mr. **Woodward**. That is correct.

Mr. **Duncan**. Are you recognizing this case in all jurisdictions?

Mr. **Woodward**. The Supreme Court decision, certainly. What is being recognized in all jurisdictions?

Mr. **Duncan**. You do not know that?

Mr. **Woodward**. What decision?

Mr. **Duncan**. The decision that was made in the *Keinath* v. *Commissioner.*

Mr. **Woodward**. That was not followed by the Government in circuits other than the eighth circuit.

Mr. **Duncan**. Is that right?

Mr. **Woodward**. That is correct.

Mr. **Duncan**. Is that what you are doing now? Are you following that in the eighth circuit?

Mr. **Woodward**. No, because the Supreme Court has determined that that was an incorrect decision of law. I must say that the Government does not invariably continue to litigate cases that are decided adversely to it by one circuit court of appeals. It only does so when it has a fairly strong view that that circuit court opinion is wrong and it wants to try to continue to litigate the issue. There are many times in which those decisions are followed by the Government where the issue is not one that is so bothersome as this decision was, or where the feeling is that the court did not make a mistake.

Many times the Government does accept a single circuit's decision, but not here.

Mr. **Duncan**. There has been a number of bills that have passed introduced that would require the service to recognize a decision unless they did appeal—of course, you do elect not to appeal in some cases, not that this particular one would require you to, because then you would be favoring people in one jurisdiction over another jurisdiction.

Mr. **Woodward**. The problem with that kind of legislation is that it would put more pressure on the Supreme Court to take cases where there has been one court of appeals decision on the issue. The Supreme Court has problems with its own docket backlog of cases. The current practice has worked pretty well, in general.

Mr. **Duncan**. But you don't think people of one jurisdiction or circuit should be favored over people that reside in another circuit?

Mr. **Woodward**. Sometimes taxpayers, as in this case, can remove themselves to the favorable jurisdiction if it is worth enough money.

Mr. **Duncan**. Thank you, Mr. Chairman.

Chairman **Rangel**. I would like to ask you to stay there, Mr. Woodward.

Mr. **Woodward**. I have a comment on the private letter ruling which has been discussed.

Chairman **Rangel**. OK. After you do that, I would ask perhaps if you could comment on the testimony of the three lawyers to see whether or not the Government may have changed its position after listening to their eloquent explanation of the inequities suffered by their clients.

Do you want to speak to the question of the private letter ruling?

Mr. **Woodward**. Yes.

When we were made aware of the 1966 ruling by counsel for one of the taxpayers involved in this controversy, we asked the IRS to search its files for private letter rulings. They produced a 1968 private letter ruling which I do not believe has been disclosed publicly. As you know, the private letter rulings were never publicly disclosed until the Freedom of Information Act litigation required them to be so. That was in the early seventies, 1975 or thereabouts.

At that time, the Service began processing old rulings, was required to disclose them, but was not required to disclose rulings that were determined to be not significant—where the determination was made they did not deal with a significant issue. Apparently this 1968 ruling was one that was determined not to be required to be disclosed—I would think at the time because the law had changed, with the 1976 legislation adopting a specific disclaimer statute—and a person making that determination, who would have been at a fairly low level at the IRS, decided not to disclose the letter ruling.

At any rate, there is a 1968 private letter ruling involving facts essentially equivalent to these cases in which the Government held, in response to a request for a ruling favorable to the taxpayer, that the reasonable time period had passed when a trust that had been in existence for some 40 years after the beneficiary had reached the age of majority was proposed to be disclaimed.

It is not very likely to my mind that the Supreme Court's 6-to-3 majority would have been affected much at all by any disclosure of a 1966 private letter ruling which was then rejected by a subsequent ruling 2 years later, and again was rejected when the IRS wrote up the deficiency in the *Keinath* case and took the case to the Tax Court in 1969. It is clear that the Government's public position—with this one exception of the 1966 private letter ruling, which was not reviewed at a very high level within the IRS—its public position was consistent on the meaning of the regulation.

Chairman RANGEL. Is Mr. Warden here?

Mr. BENNETT. We had made a request to the Service under the Freedom of Information Act for revenue rulings on this point, and Mr. Duncan asked me earlier whether we had searched this. We did search the Lexis system and the only one that showed up is the 1966 ruling.

I would be interested if we could get the cite on the 1968 ruling.

Mr. WOODWARD. I don't think there is a cite, but I would be happy to give you a copy of it.

Chairman RANGEL. Mr. Worthy.

Mr. WORTHY. We are quite astonished at the 23d hour and 59th minute we are told about a ruling when we had requested other rulings before and we ran them through Lexis and this is the only one we could find.

Chairman RANGEL. Mr. Woodward, please provide a copy to the subcommittee. Mr. Worthy, we will make certain that a copy is provided to you.

[The information follows:]

OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

MAY 10 1984

Dear Mr. Chairman:

Enclosed is a copy of the 1968 private letter ruling which was discussed at Monday's hearing on disclaimers. We hope that this material will be of assistance to the Ways and Means Committee in its consideration of this issue.

Sincerely,

Robert G Woodward
Robert G. Woodward
Tax Legislative Counsel

The Honorable
Charles B. Rangel
Chairman, Subcommittee on Oversight
of the House Ways and Means Committee
U.S. House of Representatives
Washington, D.C. 20515

Enclosure

SUBJECT FILE COPY

MAR 20 1968 T:MS:EO

[redacted], [redacted]
[redacted]
[redacted]
[redacted]

In re: [redacted]

Dear [redacted]

Ringer case law 2511.15-00

In your letter of November 13, 1967, you request a ruling with respect to the gift tax consequences of a proposed disclaimer by the above-named taxpayer of his interest in the trust created under the will of his grandfather [redacted]

[redacted], a resident of Minnesota, died in [redacted]. He bequeathed the residue of his estate in trust, the income from which was to be paid equally to his wife and children. If any of his children died before termination of the trust, that child's share of the income was to be paid to his issue in equal shares. The trust is to terminate upon the death of the survivor of his wife and children at which time the trust estate is to be distributed to the then surviving grandchildren, of the issue of any deceased grandchild.

[redacted]'s wife and five of his children are dead. The last surviving child is Mrs. [redacted], aged 94, the mother of [redacted] [redacted], the taxpayer. Mr. [redacted], who was born on [redacted], was only aged 9 when his grandfather died. His interest has not yet become indefeasibly fixed and he has not yet accepted any interest in the trust.

Mr. [redacted] now proposes to disclaim his interest in the trust. A ruling is requested that the execution of such proposed disclaimer will not constitute a transfer subject to the Federal gift tax.

Section 2501 of the Internal Revenue Code of 1954 provides for the imposition of a gift tax on the transfer of property by gift during 1955 and subsequent years. Section 2511 of the Code provides that the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. Section 25.2511-1(c) of the Gift Tax Regulations provides, in substance, that where the law governing the administration of the decedent's estate gives a beneficiary a right to completely and unqualifiedly refuse to accept ownership of property transferred from a decedent, a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocal and effective under the local law. There can be no refusal of ownership after its acceptance. In the absence of facts to the contrary, if a person fails to refuse to accept a transfer to him of ownership of a decedent's property within a reasonable time after learning of the existence of the transfer, he will be presumed to have accepted the property.

No text of the proposed disclaimer has been submitted. For purposes of the present discussion, however, it is assumed, as indicated in your letter, that it would be complete and unequivocal and in accordance with the provisions of section 525.532 of the Minnesota Statutes. This being so, the question to be resolved is whether the disclaimer would be made "within a reasonable time" after "knowledge" of existence of the transfer. This, of course, is strictly a factual matter and by its very nature any such determination must be made on the basis of the surrounding facts of each case. That the disclaimer be filed within a reasonable time is a requirement that the Internal Revenue Service has imposed and the standard or criterion to be used is basically a Federal matter. Kathryn S. Fuller v. Commissioner, 37 T.C. 147 (1961). See Mertens, Law of Federal Gift and Estate Taxation (1959), section 34.14. This is in addition to the requirement that the disclaimer be effective under local law.

A period of approximately 56 years elapsed between the death of the testator and the decision of Mr. [redacted] to renounce his interest under the testamentary trust. Approximately 17 years elapsed between the death of the testator and the time Mr. [redacted] reached his majority on [redacted]. It is conceded that, until that date, he was under legal disability and could not validly have disclaimed his interest. This, however, does not apply with respect to the period of over 44 years since that date.

You point out in your letter that Mr. [redacted] "has neither been finally ascertained as the beneficiary nor has his interest become indefeasibly fixed." The fact that his interest is contingent on his survival of his mother, the life tenant, does not, in itself, exclude the alienation of such interest from the category of a taxable transfer. In cases involving gifts by a donor of interests received under the will or estate of another, the term "property" for gift tax purposes includes a vested remainder subject to defeasance. Proctor v. Commissioner, 151 F. 2d 603 (1945); Goodwin, Exrs. v. McGowan, 47 F. Supp. 798 (1942); section 25.2511-1(h)(6) of the regulations. The fact that the value of the gift is speculative, uncertain, and contingent upon future developments is, in principle, an immaterial factor in determining whether a gift was made. Galt v. Commissioner, 216 F. 2d 41 (1954), certiorari denied, 348 U.S. 951 (1954).

Under the circumstances, it must be concluded that the proposed disclaimer by Mr. [redacted] of his interest in the testamentary trust created under the will of his grandfather does not satisfy the requirement of timeliness prescribed by section 25.2511-1(c) of the regulations. Consequently, the disclaimer will result in a gift for Federal gift tax purposes.

It is important that a copy of this ruling be attached to the gift tax return to be filed if the proposed transaction is consummated. A copy is enclosed for that purpose.

Very truly yours,

(Signed) Ira H. Hansen

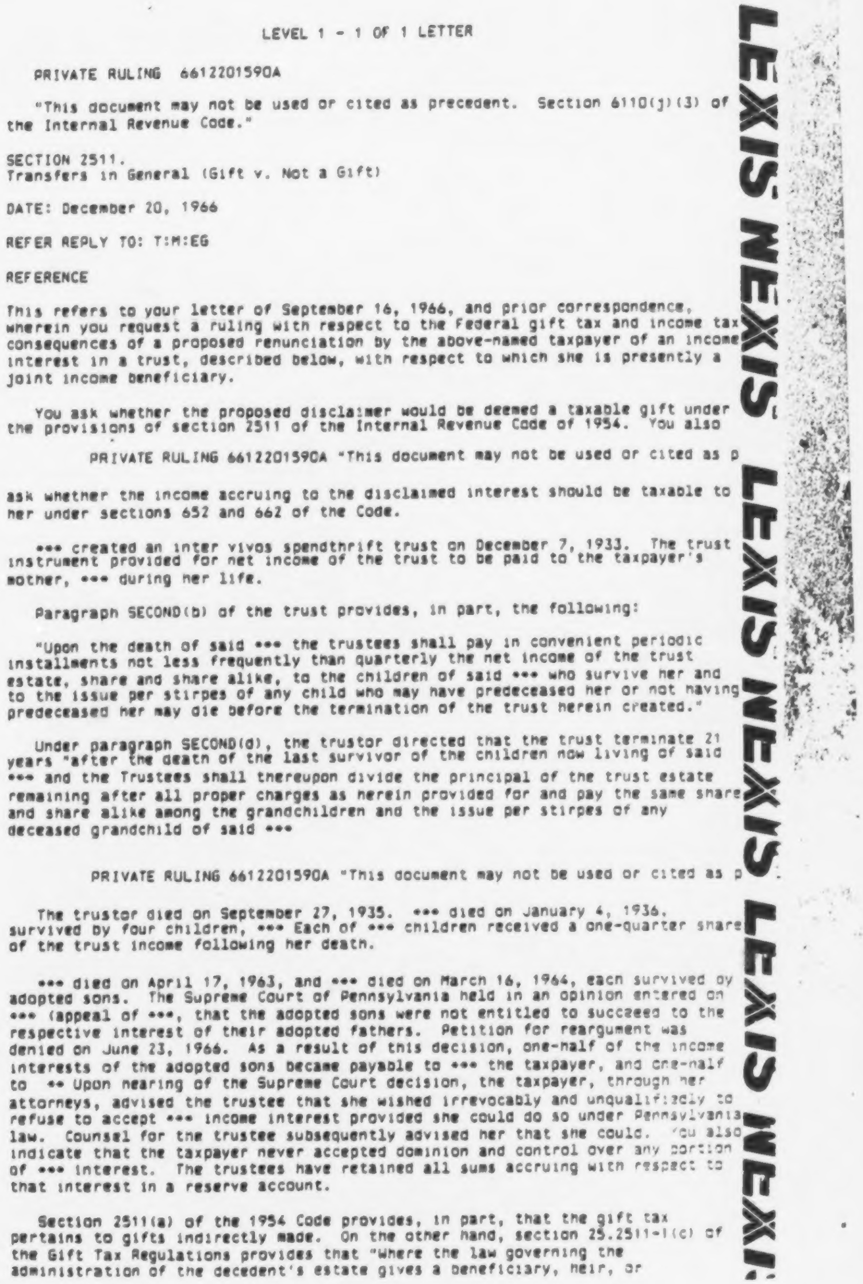
Chief, Estate and Gift Tax Branch

(Copy of this letter enclosed.)
cc: DDIR, [redacted], [redacted]
Attention: Chief, Audit Division

KMFincham:mbt
3-14-68

Mr. **Bennett**. With regard to the 1966 ruling, the point is that the Supreme Court posed the question to taxpayer's counsel whether the Government's position was consistent throughout this period, and his response was yes, and it was not consistent. There was the inconsistency related to the 1966 letter ruling.

[The ruling follows:]



LEVEL 1 - 1 OF 1 LETTER

PRIVATE RULING 6612201590A

"This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code."

SECTION 2511.
Transfers in General (Gift v. Not a Gift)

DATE: December 20, 1966

REFER REPLY TO: T:M:EG

REFERENCE

This refers to your letter of September 16, 1966, and prior correspondence, wherein you request a ruling with respect to the Federal gift tax and income tax consequences of a proposed renunciation by the above-named taxpayer of an income interest in a trust, described below, with respect to which she is presently a joint income beneficiary.

You ask whether the proposed disclaimer would be deemed a taxable gift under the provisions of section 2511 of the Internal Revenue Code of 1954. You also ask whether the income accruing to the disclaimed interest should be taxable to her under sections 652 and 662 of the Code.

*** created an inter vivos spendthrift trust on December 7, 1933. The trust instrument provided for net income of the trust to be paid to the taxpayer's mother, *** during her life.

Paragraph SECOND(b) of the trust provides, in part, the following:

"Upon the death of said *** the trustees shall pay in convenient periodic installments not less frequently than quarterly the net income of the trust estate, share and share alike, to the children of said *** who survive her and to the issue per stirpes of any child who may have predeceased her or not having predeceased her may die before the termination of the trust herein created."

Under paragraph SECOND(d), the trustor directed that the trust terminate 21 years "after the death of the last survivor of the children now living of said *** and the Trustees shall thereupon divide the principal of the trust estate remaining after all proper charges as herein provided for and pay the same share and share alike among the grandchildren and the issue per stirpes of any deceased grandchild of said ***

The trustor died on September 27, 1935. *** died on January 4, 1936. survived by four children, *** Each of *** children received a one-quarter share of the trust income following her death.

*** died on April 17, 1963, and *** died on March 16, 1964, each survived by adopted sons. The Supreme Court of Pennsylvania held in an opinion entered on *** (appeal of ***, that the adopted sons were not entitled to succeed to the respective interest of their adopted fathers. Petition for reargument was denied on June 23, 1966. As a result of this decision, one-half of the income interests of the adopted sons became payable to *** the taxpayer, and one-half to ** Upon hearing of the Supreme Court decision, the taxpayer, through her attorneys, advised the trustee that she wished irrevocably and unqualifiedly to refuse to accept *** income interest provided she could do so under Pennsylvania law. Counsel for the trustee subsequently advised her that she could. You also indicate that the taxpayer never accepted dominion and control over any portion of *** interest. The trustees have retained all sums accruing with respect to that interest in a reserve account.

Section 2511(a) of the 1954 Code provides, in part, that the gift tax pertains to gifts indirectly made. On the other hand, section 25.2511-1(c) of the Gift Tax Regulations provides that "Where the law governing the administration of the decedent's estate gives a beneficiary, heir, or

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next-of-kin a right to completely and unqualifiedly refuse to accept ownership of property transferred from a decedent . . ., a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocable and effective under the local law. There can be no refusal of ownership of property after its acceptance. . . . In any case where a refusal is purported to relate only to a part of the property, the determination of whether or not there has been a complete and unqualified refusal to accept ownership will depend on all the facts and circumstances in each particular case, taking into account the recognition and effectiveness of such a purported refusal under the local law."

An income beneficiary of a spendthrift trust may renounce a portion of that income interest under the law of Pennsylvania. See Gallagher v. Smith, 223 F. 2d 218 (1955).

The trustor expressed his intent to have the income interest of his grandchildren devolve to their issue, we construe the intent of the trustor to provide that any renounced income interest by the grandchildren shall pass to their natural children.

In view of the foregoing, it is held that taxpayer's proposed renunciation will not result in a taxable transfer of that interest for gift tax purposes to her natural children if such renunciation is executed within a "reasonable time" from the time that she first received notice of her right to the additional income interest. If the proposed renunciation is executed at the present time, the execution would be effected within a "reasonable time" within the meaning of section 25.2511-1(c) of the regulations. Cf. Kathryn S. Fuller v. Commissioner, 37 T. C. 147 (1961). As indicated above, the taxpayer has not accepted the subject interest at the present time.

Section 652(a) of the Internal Revenue Code provides, in part, that the amount of income for the taxable year required to be distributed currently by a trust shall be included in the gross income of the beneficiary to whom the income is required to be distributed, whether distributed or not.

Section 301.3 of Title 20 of Purdon's Pennsylvania Statutes Annotated permits an income beneficiary of a Pennsylvania spendthrift trust to release or disclaim his right to income from the trust, provided that such released or disclaimed income passes to one or more of the beneficiary's descendants. The trust income proposed to be disclaimed by the taxpayer in the instant case would pass to her children.

Since the proposed disclaimer of trust income by the taxpayer would be effective and irrevocable under local law, the taxpayer would not be required to include in her gross income, under section 652(a) of the Code, the income subsequently accruing to the trust. However, income accrued to the trust which would be distributable to the taxpayer before she makes her disclaimer will be includible in her gross income, notwithstanding, the fact that it is actually paid to her children. Revenue Ruling 64-62, C. B. 1964-1 (Part 1) 221.

Very truly yours,
(Signed) Lester H. Wallace
Acting Chief, Estate and Gift Tax Branch

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Chairman **Rangel**. Why don't you two just sit here and listen to Robert Warden, counsel from the firm of McDermott, Will & Emery. He is here to discuss the inequities that adversely affected the estate of George W. Bunn.

## STATEMENT OF ROBERT A. WARDEN, COUNSEL, McDERMOTT, WILL & EMERY, ON BEHALF OF THE SPRINGFIELD MARINE BANK AS EXECUTOR OF THE ESTATE OF GEORGE W. BUNN, JR.

Mr. **Warden**. Thank you, Mr. Chairman.

In the interest of time, I will try to shorten somewhat an already brief statement.

In general, we support the position of Mr. Worthy and Mr. Bennett.

Chairman **Rangel**. Your full statement, without objection, will be entered into the record.

Mr. **Warden**. I am Robert A. Warden, a partner in the Washington office of McDermott, Will & Emery. I am appearing today on behalf of the Springfield Marine Bank.

The Springfield Marine Bank is the executor of the estate of George W. Bunn, Jr. Mr. Bunn's aunt, Alice E. Bunn, devised a portion of her estate to the Springfield Marine Bank to be held in trust. The trustee was directed to pay one-half of the income of the trust to her nephew, George W. Bunn, Jr., then 63, for a period of 20 years. The will further provided that if her nephew survived this 20-year period, than an interest in one half of the trust corpus would fully vest in him. If he did not survive, this interest would then pass to his three children.

Five years later, in 1958, the regulation here in question was promulgated and the Treasury now claims that the significance of that regulation is that a disclaimed interest is created at a time when the original instrument establishing the interest became effective. For reasons already discussed at some length, it is our position that this was by no means clear at the time because of the private ruling, the *Keinath* decision, and so forth.

I was interested to hear Mr. Woodward admit that the service does often in fact not appeal adverse decisions and at the time of our disclaimer, in 1973, immediately after the *Keinath* case and 1 day after the interest vested, it was by no means clear that the matter had not been brought to rest. But in any event, to us the crucial date is 1953, when the interest was created, and the law in 1953 is ably discussed in Mr. Worthy's brief, particularly pages 5 through 8. Certainly she had no clue that this regulation was going to be issued 5 years later.

We believe that H.R. 2813, as introduced by Congressman Conable and others, would correct this situation which we perceive to be an inequity and would urge its enactment.

[The prepared statement follows:]

## STATEMENT OF ROBERT A. WARDEN, COUNSEL, SPRINGFIELD MARINE BANK, AS EXECUTOR OF THE ESTATE OF GEORGE W. BUNN, JR.

### SUMMARY

1. Prior to November 15, 1958, when Treasury amended its regulations with regard to disclaimers of interests in property, there was no indication that disclaimers made immediately after an interest had vested might be taxable as gifts.

2. Persons holding interests in property created prior to November 15, 1958, were unfairly treated because of this retroactive change in law.

3. H.R. 2813 should be enacted to prevent unfairness to taxpayers disclaiming interests created before the change in Treasury regulations.

### STATEMENT

My name is Robert A. Warden. I am a partner in the Washington office of McDermott, Will & Emery. I am appearing today on behalf of the Springfield Marine Bank in support of H.R. 2813.

The Springfield Marine Bank is the executor of the estate of George W. Bunn, Jr. Mr. Bunn's aunt, Alice E. Bunn, devised a portion of her estate to the Springfield Marine Bank of Springfield, Illinois, to be held in Trust. The trustee was directed to pay one-half of the income of the trust to her nephew, George W. Bunn, Jr., then 63, for a period of 20 years. The will further provided that if her nephew survived this 20-year period, than an interest in one-half of the trust corpus would fully vest in him. If he did not survive, this interest would then pass to his three children.

In 1953, at the time the interest here was created, case law was clear that a disclaimer which was valid under state law was also valid for federal tax purposes.

In 1958, five years after the death of Alice Bunn, the Internal Revenue Service issued Regulation Section 25.2511-1(c) which provided in relevant part that a disclaimer or refusal must be "made within a reasonable time after knowledge of the existance of the transfer;" otherwise the disclaimer would be treated as a gift from the party making the disclaimer to the other beneficiaries under the will or trust instrument.

The ultimate effect of this change in the regulations is that the IRS now asserts that after 1958, for federal gift tax purposes, a disclaimed interest is created at the time when the original instrument establishing the interest became effective and not when the interest became vested.

But this was by no means clear at the time. In fact, in a 1966 private letter ruling the IRS allowed the disclaimer of an interest created 33 years earlier, but which had only recently become possessory. The IRS did not publicly assert its current interpretation of the law until the litigation in *Keinath* v. *Commissioner,* 58 T.C. 352, rev'd. 480 F.2d 57 (8th Cir. 1973), 15 years after the regulation was promulgated. The Eighth Circuit reversed the Tax Court and held that the reasonable time requirement for a valid disclaimer pertains not to the time immediately after the creation of an interest, but to the time immediately after the interest became vested or possessory. The Eighth Circuit's opinion in *Keinath* was announced on May 8, 1973. Mr. Bunn made his disclaimer on August 10, 1973.

However, this issue was relitigated and on February 23, 1982, the Supreme Court handed down its decision in *Jewett* v. *Commissioner* 455 U.S. 305. In a six to three decision the Court held that the word "transfer" as found in the regulation, refers to the time when the interest was created and not to a later time when the interest vests or becomes possessory.

Whatever the merits of the rule in *Jewett* as applied to future cases, we feel that the regulatory and judicial history of this matter operates to work a serious injustice on the estate of Mr. Bunn. At the time when the original trust was created in 1953, the Treasury regulations which the IRS now relies on were not even in effect. Mr. Bunn did execute a disclaimer of his interest in the corpus, valid under Illinois state law, one day after that interest vested and also within a few months of the court decision in the *Keinath* case which held that such a disclaimer was valid for federal tax purposes. Mr. Bunn had not accepted his interest in the corpus or any of its benefits at the time of his disclaimer. Treasury now says that disclaimer should have been made in 1953, five years before the regulation was promulgated and 20 years before the IRS first litigated the issue, unsuccessfully, in 1973.

H.R. 2813 as introduced by Congressman Conable, Congressman Guarini, and Congressman Lundine would correct this situation by providing a transition rule for a disclaimer of an interest created by a transfer made before November 15, 1958. Under the bill, the disclaimer of such an interest would be valid for federal tax purposes if made at any time prior to 90 days following the date of enactment of this legislation. We believe that such a solution is fair and urge the enactment of this legislation.

Chairman **Rangel**. Counsel for the Government, for Treasury, would you care to respond to any of the questions of equity that are raised by counsel for these estates?

Mr. **Woodward**. Mr. Chairman, I think that we addressed most of those in our written statement. Nothing we have heard here is new. The appeal being made to the Congress is exemplified by a very small number of well-represented taxpayers with millions of dollars at stake seeking redress from an adverse decision by the Supreme Court. None of these taxpayers are questioning the fact that there have been transmissions of wealth here, the kind of transmissions that the gift tax is designed to tax.

There is an argument about change of position, but there is no argument about the fundamental policy concerns, the policy aspects. No one is arguing that transfers of this type shouldn't be subject to tax. I think it would be ludicrous to do so and clearly the taxpayers have not made such arguments even in the Supreme Court.

I have a question about some of the dollar amounts represented. I don't have the court opinions, but my understanding was that the dollar amounts involved in the Halbach estate situation were significantly more than $2 million, in the range of $5 million to $6 million. I was surprised to hear that figure cited.

Again, we have no one coming forth to say who is going to benefit from the 90-day window period. I don't know if there may be representatives of those individuals here in the room. Obviously they would not find it in their interests to disclose themselves, but I think that that is something that is very troublesome and I think provides a compelling reason for the Congress to reject this legislation.

Chairman **Rangel**. Mr. Duncan.

Mr. **Duncan**. Thank you, Mr. Chairman. I have no further questions.

Mr. **Bennett**. Mr. Chairman, If I may on the revenue subject.

Chairman **Rangel**. Mr. Bennett.

Mr. **Bennett**. Let me read from the part of the Deficit Reduction Act of 1984, a Senate bill.

> The revenue effect of this provision will have negligible effect on Federal budget receipts. However, government outlays in tax refunds are estimated to be increased by $10 million the first year; $30 million in 1985, and less than $5 million annually for subsequent years.

That may relate, in part—obviously the subsequent years would relate—to the window period, I would guess.

Chairman **Rangel**. Let me make it clear as to why we are having these hearings. As you know, we are about to go to conference on the House-Senate bill where many matters are in disagreement between the House and the Senate side. Chairman Rostenkowski has set as a policy going into these conferences that the House will consider no matter that we have not had hearings on.

Mr. Conable was one of the prime sponsors of this legislation and has requested that if this matter be accepted in conference, that it should not be rejected because we have not had hearings, and that the legislation should be evaluated on its merits.

That is the reason why the full committee chairman has asked me to listen to the arguments that proponents of the bill had as well as the position taken by Treasury.

I want to thank you for your most eloquent arguments and I thank the Government for staying after your testimony to assist us in resolving this issue.

There being no——

Mr. **Worthy**. Mr. Chairman, I neglected at the end of my testimony to request that a technical analysis that I had prepared and previously submitted to the subcommittee be included in the record, if I may.

Chairman **Rangel**. Without objection.

There being no further witnesses, the subcommittee stands adjourned.

[Whereupon, at 3:02 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

MAYER, BROWN & PLATT

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May 11, 1984

By Hand

The Honorable Charles B. Rangel
Chairman
Subcommittee on Oversight
Committee on Ways and Means
Longworth House Office Building
Washington, D. C. 20510

Dear Mr. Chairman:

This statement is submitted for the record of your May 7, 1984, hearing on federal tax rules relating to disclaimers of property interests, including Mr. Conable's bill (H.R. 2813) and the counterpart provisions included as section 803 of the Deficit Reduction Act of 1984 recently approved by the Senate as an amendment to H.R. 2163.1/ The bill and the Senate counterpart would, of course, treat certain disclaimers of pre-1958 interests as qualified for federal transfer tax purposes.

## Summary of Position

We support the bill. Application of the Supreme Court decision in Jewett v. Commissioner, 455 U.S. 305, 102 S. Ct. 1082 (1982), to interests in property created by transfers made prior

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1/ Section 803(a), adding paragraph (4) to Code subsection 2518(c). S. Prt. No. 98-169, 98th Cong., 2d Sess., vol. II at 913 (1984).

to the date the Treasury first announced its position on disclaimers (November 15, 1958) is fundamentally unfair. Holders of such interests have been denied the opportunity to make disclaimers of such interests which are treated as qualified for federal estate, gift, and generation-skipping tax purposes. All holders of similar interests created after this date have enjoyed this opportunity. Remedial legislation is appropriate to cure this inequality.

## Background

In the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976), Congress changed the law governing the time for making disclaimers by amending Code section 2518(b). The Congressional action, however, was prospective only, i.e., it applies only to transfers creating an interest after December 31, 1976. Tax Reform Act of 1976, Pub. L. 94-455, §2009(e)(2), 90 Stat. at 1896; H.R. Rep. No. 94-1380, 94th Cong., 2d Sess. 67-68, reprinted in 1976-3 C.B. (Vol. 3) 801-02.

In the Jewett case, the Internal Revenue Service sought to extend the prospective application of section 2518 to transfers of interests created prior to 1977. The Service contended the disclaimer of a pre-1977 interest in property should be taxable as a gift unless made within a reasonable period after the disclaimant gained knowledge of the transfer giving rise to the interest, even if the interest was contingent at the time such knowledge was obtained. The taxpayer argued that disclaimers, valid under state law, were valid for federal tax purposes as well. The Supreme Court ruled for the Commissioner.

## Transferees of Pre-1958 Interests Have Been Denied the Right To Disclaim

The Supreme Court based its holding on Treasury regulations, promulgated in 1958, providing that disclaimers should be excluded from federal transfer taxes only if such disclaimers (1) are effective under local law and (2) are made within a reasonable time after knowledge of the existence of the transfer. The 1958 regulations constituted the first statement of the government's position in this matter. By their terms, the regulations apply to interests in property created before their promulgation, as well as after. However, as noted in the Oversight Subcommittee's press release of April 30, 1984, the practice of the Service, prior to the promulgation of the 1958 regulations, had been to treat, as qualified, any disclaimer made in accordance with local law.

As a result of the 1982 Jewett interpretation of the 1958 regulations, transferees of pre-November 15, 1958, interests have now learned that they have been denied the right to disclaim those interests without treating their disclaimers as taxable transfers. To avoid this consequence, a taxpayer must either

(1) have been clairvoyant and, thus, have anticipated the substance of the 1958 regulations prior to their promulgation or (2) have become first aware of the interest to be disclaimed only after such promulgation. In simplest terms, by the 1958 regulations as interpreted in 1982 by the Jewett court, those taxpayers who were adults in 1958 and aware of their future interests in property, however contingent, were denied the right ever to disclaim those interests without transfer taxes.

## The Supreme Court May Have Overlooked the Problem

The Supreme Court may have been unaware of the impact of its own ruling on taxpayers with pre-1958 contingent interests. In the Court's decision, as originally reported, Justice Stevens, speaking for the majority, said:

> In the Tax Reform Act of 1976, Congress established specific standards for determining whether a disclaimer constitutes a taxable gift; those new standards would support the Commissioner's position in this case if the disclaimers had been executed after the effective date of the Act. 50 U.S.L.W. 4218 (U.S. Feb. 23, 1982). [Emphasis added.]

This interpretation of the section 2518 effective date was clearly erroneous. The error was called to the Court's attention by participants in the Jewett case. In final form, the opinion provided:

> In the Tax Reform Act of 1976, Congress established specific standards for determining whether a disclaimer constitutes a taxable

> gift; those new standards would support the Commissioner's position in this case if the original transfers had occurred after the effective date of the Act. 102 S.Ct. at 1090. [Emphasis added.]

The difference in the language used by the Court is significant. The initial version suggests that the majority of the Court may have held the mistaken view that this area of the law was preempted in 1976 by the Congress at least as to disclaimers made after 1976. This view is not correct.

## Conclusion

Holders of pre-1958 interests have been unfairly deprived of the opportunity to disclaim such interests. Provision should be made to provide such individuals with the same opportunities afforded others. They should now be permitted to disclaim such interests as contemplated by H.R. 2813 and section 803 of the Deficit Reduction Act recently passed by the Senate.

We would, of course, welcome the opportunity to pursue this matter with you or your staff.

Respectfully submitted,

Jerry L. Oppenheimer

Howard M. McCue III

Howard M. McCue III

JLO/HMMcC/sr

DEMOCRATIC
NATIONAL COMMITTEE *1625 Massachusetts Ave., N.W. Washington, D.C. 20036 (202)797-5900*

May 7, 1984

BY HAND

John Solomon, Esquire
Chief Counsel
Committee on Ways and Means
United States House of Representatives
1102 Longworth Building
Washington, D. C. 20515

Re: Submission for the May 7, 1984
Record of Hearings on H.R. 2813
Before the Subcommittee on Oversight
of the Committee on Ways and Means

Dear Mr. Solomon:

I would appreciate inclusion in the Oversight Subcommittee Hearing record of May 7, 1984, of the following submission from the law firm of Mitchell, Silberberg & Knupp of Los Angeles, California.

It is my hope that in weighing the equities involved in H.R. 2813, the Committee will not fail to consider situations such as that presented in this attachment. In this case, the widow received no benefit from the general power of appointment which she disclaimed as soon as she became aware of it. The estate will ultimately be distributed as provided under her husband's will. She, however, is now in a position where because of changing and unclear tax laws, she may be required to pay a substantial gift tax on assets in which she neither had nor sought any tangible interest.

Thank you for your consideration of this matter.

Sincerely,

Florence Franklin

Florence Franklin
Democratic National Committee
Special Projects

Enclosure.
cc: James Jennings, Esq.

LAW OFFICES
MITCHELL, SILBERBERG & KNUPP
A PARTNERSHIP OF PROFESSIONAL CORPORATIONS
1800 CENTURY PARK EAST
LOS ANGELES, CALIFORNIA 90067

MEMORANDUM

Date Sept. 27, 1983

TO: Honorable Sala Burton
1429 Long House Office Building
Washington, D. C.

FROM: J. B. Jennings

SUBJECT: S. 1180

We represent the widow of Herman H. who died in January, 1954. His Will contained a "Widow's Election." His wife, Louise, agreed to subject her share of their community property to probate. Under Mr. H's Will, the residue of his estate passed to a trust. Louise was granted a testamentary power of appointment over the trust. The power allows Louise "to designate and appoint the person or persons who, upon my wife's death, shall be entitled to take and receive the whole of the principal or corpus of the trust estate."

While the dispositive provisions in Mr. H's Will were virtually identical with Louise's desires, she was never advised that it was possible for her to disclaim her power of appointment and thereby pass her husband's share of the community property to their four children and ultimately to their grandchildren free from her estate.

In 1971, Louise became belatedly aware of the possibility of such a disclaimer and in July, 1971 she did, in fact, recognize and relinquish the general testamentary power of appointment granted to her under her late husband's Will as to his one-half of the community property assets held in the trust corpus.

For virtually 40 years of widowhood, from her early 40's to her 70's, she has consistently maintained a desire to pass her husband's and her estate to her children and grandchildren in the manner provided in Mr. H's Will.

It is hoped that her descendants will not be penalized by her ignorance of the possibility of a simple disclaimer. We appreciate the efforts of the Congress to correct this inequity.

JBJ:rp